Chapter 4. Borrower Eligibility and Credit Analysis

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Section A. Borrower Eligibility Requirements

Overview

In This Section

This section contains the topics listed in the table below.

1. Borrower, Coborrower and Cosigner Eligibility Requirements

Introduction

This topic contains information on borrower, coborrower, and cosigner eligibility requirements, including

- who is eligible for Federal Housing Administration (FHA) mortgage insurance
- borrower age limits
- determination of creditworthiness
- borrower and coborrower requirements
- cosigner requirements
- additional coborrower and cosigner requirements
- military personnel eligibility,
- veteran eligibility documentation requirements, and
- title issues regarding non-borrowing spouses or other parties in interest.

Change Date

March 29, 2010

4155.1 4.A.1.a Who Is Eligible for FHA Mortgage Insurance

FHA insures mortgages made

- to individuals with a valid Social Security number (SSN), and
- under the conditions described in this section, to
  - – state and local government agencies, and
  - – approved nonprofit organizations.

Note: Employees of the World Bank, foreign embassies, etc., may not be required to have an SSN. Conclusive evidence of this exception must be provided.

***Reference*:** For more information on evidence of Social Security Number, see HUD 4155.1 1.3.b.

4155.1 4.A.1.b Borrower Age Limits

There is no *maximum* age limit for a borrower. The *minimum* age is the age for which a mortgage note can be legally enforced in the state, or other jurisdiction where the property is located.

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1. Borrower, Coborrower and Cosigner Eligibility Requirements, Continued

4155.1 4.A.1.c Determination of Credit Worthiness and Minimum Credit Score Requirement

When determining the mortgage creditworthiness of borrowers, coborrowers, or cosigners, the underwriter takes the following into consideration:

- income
- assets
- liabilities, and
- credit history.

Borrowers with decision credit scores below 500 and with loan-to-value ratios at or above 90 percent are not eligible for FHA-insured mortgage financing.

4155.1 4.A.1.d Borrower and Coborrower Requirements

Both occupying and non-occupying borrowers and coborrowers

- take title to the property at settlement
- are obligated on the mortgage note, and
- must sign all security instruments.

Reference: For additional information on borrower and coborrower eligibility requirements, see HUD 4155.1 4.A.1.f.

4155.1 4.A.1.e Cosigner Requirements

Cosigners

- do *not* hold ownership interest in a property
- *are* obligated on the mortgage note and liable for repaying the obligation, and
- must complete and sign all loan documents except the security instruments.

Reference: For additional cosigner eligibility requirements, see HUD 4155.1 4.A.1.f.

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1. Borrower, Coborrower and Cosigner Eligibility Requirements, Continued

4155.1 4.A.1.f Additional Borrower and Coborrower Eligibility

The table below describes additional requirements and conditions for coborrowers and cosigners.

Condition/Requirement	Description
Financial Interest Prohibited	A party who has a financial interest in the mortgage loan transaction, such as the seller, builder, or real estate agent, may *not* be a coborrower or a cosigner. ***Exception***: Exceptions may be granted when the party with the financial interest is related to the borrower by blood, marriage, or law. ***Reference:*** For more information on identity of interest transactions, see HUD 4155.1 2.B.2.
Basic Ineligibility for Participation	An individual signing the loan application must not be otherwise ineligible for participation in the mortgage loan transaction for reasons as described in HUD 4155.1 4.C. ***Note***: This condition applies to all borrowers, regardless of occupancy status.
Principal United States (U.S.) Residence	Non-occupying coborrowers or cosigners must have a principle residence in the U.S., unless exempted • due to military service with overseas assignments, or • as a U.S. citizen living abroad.

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1. Borrower, Coborrower and Cosigner Eligibility Requirements, Continued

4155.1 4.A.1.g Military Personnel Eligibility

Military personnel are considered occupant-owners, and eligible for maximum financing if a member of the immediate family will occupy a property as the principal residence, whether or not the military person is stationed elsewhere.

Reference: For information on eligibility documentation requirements for FHA-insured mortgages to veterans, see HUD 4155.1 4.A.1.h.

4155.1 4.A.1.h Veteran Eligibility Documentation Requirements

A completed Certificate of Veteran Status (CVS, VA Form 26-8261) issued to a veteran borrower is the only document that may be used for program eligibility. The Department of Veterans Affairs is solely responsible for determining eligibility for a CVS and its subsequent issuance.

Requests for a CVS must be sent on VA Form 26-8261a, along with proof of military service, to the appropriate VA Eligibility Center. This form is available at http://www.va.gov/vaforms/.

4155.1 4.A.1.i Title Issues Regarding Non-Borrowing Spouses or Other Parties in Interest

If two or more parties have an ownership interest in the property, but one of the parties is applying for the loan (and credit qualifies for the loan on his/her own), it is not required that the non-applicant individual(s) execute the mortgage note and mortgage, deed of trust, or security deed.

The lender is still required to ensure a valid and enforceable first lien on the property under applicable State law, which may require the execution of the mortgage, deed of trust, or security deed (but typically not the note) by all parties who have an ownership interest in the property.

If the party in question executes the mortgage, deed of trust, or security deed only and not the note, he/she is not considered a borrower for FHA purposes, and therefore need not sign the loan application or be considered in credit underwriting.

2. Ineligible Borrowers

Introduction

This topic contains information on ineligible borrowers, including

- reasons for mandatory rejection of a borrower
- waiting period for borrowers with past delinquencies and defaults, and
- lender responsibility for screening borrowers.

Change Date

March 29, 2010

4155.1 4.A.2.a Reasons for Mandatory Rejection of a Borrower

A borrower seeking to obtain an FHA-insured mortgage *must* be rejected if he/she is

- suspended, debarred, or otherwise excluded from participation in HUD's programs and appears on either the
  - HUD Limited Denial of Participation (LDP) list, or
  - General Services Administration's (GSA's) "*List of Parties Excluded from Federal Procurement or Nonprocurement Programs*," or
- presently delinquent on any Federal debt or has a lien placed against his/her property for a debt owed to the United States Government.

Notes:

- A borrower who is delinquent on a Federal debt may become eligible once he/she brings the account current or enters into a satisfactory repayment plan with the Federal agency.
- A mortgage loan is not eligible for insurance if *any party* involved in the transaction is on either of the above lists. An exception exists for a seller on the list who is selling his/her principal residence.

References: For more information on

- loan transactions that are ineligible for insurance due to *any party* being on either of the above lists, see HUD 4155.1 4.A.7.c
- exceptions to the requirement that a party on one of the above lists must be considered ineligible, see HUD 4155.1 4.A.8.e, and
- using CAIVRS to determine borrower eligibility, see HUD 4155.1 4.A.2.c and HUD 4155.1 4.A.8.

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2. Ineligible Borrowers, Continued

4155.1 4.A.2.b Waiting Period for Borrowers With Past Delinquencies and Defaults

FHA has a three-year waiting period to regain eligibility for another FHA-insured mortgage when the borrower has had past delinquencies or has defaulted on an FHA-insured loan.

The three-year waiting period begins when FHA pays the initial claim to the lender. This includes deed-in-lieu of foreclosure, as well as judicial and other forms of foreclosures.

Lenders should contact the HOC having jurisdiction over the area where the property subject to default is located for information such as the

- date the claim was paid, and
- date of the initial default.

4155.1 4.A.2.c Lender Responsibility for Borrower Screening

Lenders are responsible for screening all borrowers using HUD's Credit Alert Interactive Voice Response System (CAIVRS). A borrower is *not* eligible for an FHA-insured mortgage if CAIVRS indicates that the borrower

- is presently delinquent, or
- has had a claim paid within the previous three years on a loan made or insured by FHA.

Reference: For additional information on lender responsibility for using CAIVRS to screen borrowers, see HUD 4155.1 4.A.8.

3. Citizenship and Immigration Status

Introduction

This topic contains information on citizen and immigration status, including

- residency requirements
- lawful permanent resident aliens
- non-permanent resident aliens
- Employment Authorization Document (EAD) required as evidence of work status, and
- non-lawful residency.

Change Date

March 29, 2010

4155.1 4.A.3.a Residency Requirements

U.S. citizenship is not required for mortgage eligibility.

The lender must determine residency status of the borrower, based on

- information provided on the loan application, and
- other applicable documentation.

4155.1 4.A.3.b Lawful Permanent Resident Aliens

FHA insures mortgages for borrowers with *lawful permanent resident alien status* using the same terms and conditions as those for U.S. citizens.

The mortgage file *must*

- include evidence of the permanent residency, and
- indicate that the borrower is a lawful permanent resident alien on the Uniform Residential Loan Application (URLA).

Note: The U.S. Citizenship and Immigration Services (USCIS) within the Department of Homeland Security provides evidence of lawful, permanent residency status.

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3. Citizenship and Immigration Status, Continued

4155.1 4.A.3.c Non-Permanent Resident Aliens

FHA insures mortgages made to non-permanent resident aliens provided that the

- property will be the borrower's principal residence
- borrower has a valid SSN, and
- borrower is eligible to work in the U.S., as evidenced by an EAD issued by the USCIS.

Note: The Social Security card *cannot* be used as evidence of work status.

Reference: For more information on the requirement to use the EAD as evidence of work status, see HUD 4155.1 4.A.3.d.

4155.1 4.A.3.d EAD Required as Evidence of Work Status

Although Social Security cards may indicate work status, such as "not valid for work purposes," an individual's work status may change without the change being reflected on the actual Social Security card. For this reason, the Social Security card must not be used as evidence of work status, and the EAD must be used instead.

If the EAD will expire within one year and a prior history of residency status renewals exists, the lender may assume that continuation will be granted. If there are not prior renewals, the lender must determine the likelihood of renewal, based on information from the USCIS.

Note: Borrowers residing in the U.S. by virtue of refugee or asylee status granted by the USCIS are automatically eligible to work in this country. An EAD is *not required*.

4155.1 4.A.3.e Non-Lawful Residency

Non-U.S. citizens that do *not* have lawful residency in the U.S. are *not* eligible for FHA-insured mortgages.

4. Living Trusts

Introduction

This topic contains information on living trusts, including

- property held in living trusts, and
- living trusts and security instruments.

Change Date

March 29, 2010

4155.1 4.A.4.a Property Held in Living Trusts

Property held in a living trust is eligible for FHA mortgage insurance when an individual borrower

- remains the beneficiary, and
- occupies the property as a principal residence.

The lender must be satisfied that the trust provides reasonable means to assure that the lender will be notified of any changes to the trust regarding

- occupancy changes, or
- transfer of beneficial interest.

4155.1 4.A.4.b Living Trusts and Security Instruments

The name of the living trust must appear on the security instrument, such as the mortgage, deed of trust, or security deed.

The individual borrower must appear on the security instrument when required to create a valid lien under State law. The owner-occupant, and other borrowers if any, must also appear on the Note with the trust.

The individual borrower is not required to appear on the property deed or title.

5. Non-Purchasing Spouses

Introduction

This topic contains information on non-purchasing spouses, including

- valid first liens
- non-purchasing spouse debt, and
- non-purchasing spouse credit history.

Change Date

March 29, 2010

4155.1 4.A.5.a Valid First Liens

If required by State law in order to perfect a valid and enforceable first lien, the non-purchasing spouse may be required to sign either the security instrument or documentation indicating that the individual is relinquishing all rights to the property.

When the security instrument is executed for this reason, the non-purchasing spouse is

- *not* considered a borrower, and
- *not* required to sign the loan application.

***Note**:* Non-applicant individuals can have an ownership interest in the property at the time of settlement without executing the mortgage note and mortgage, deed of trust, or security deed, regardless of whether the transaction is a purchase or a refinance.

***Reference**:* For more information on title issues regarding non-borrowing spouses or other parties in interest, see HUD 4155.1 4.A.1.i.

Continued on next page

5. Non-Purchasing Spouses, Continued

4155.1 4.A.5.b Non-Purchasing Spouse Debt

Except for obligations specifically excluded by State law, the debts of non-purchasing spouses *must* be included in the borrower's qualifying ratios, if the

- borrower resides in a community property state, or
- property being insured is located in a community property state.

4155.1 4.A.5.c Non-Purchasing Spouse Credit History

The non-purchasing spouse's credit history is not considered a reason to deny a loan application. However, the non-purchasing spouse's obligations must be considered in the debt-to-income ratio unless excluded by State law. A credit report that complies with the requirements of HUD 4155.1 4.C.2 must be provided for the non-purchasing spouse in order to determine the debts that must be counted in the debt-to-income ratio.

Note: This requirement is applicable if the subject property or the borrower's principal residence is located in a community property state.

6. Eligibility Requirements for Nonprofit Organizations and State and Local Government Agencies

Introduction

This topic contains information on eligibility requirements for nonprofit organizations and state and local government agencies to obtain an FHA-insured mortgage, including

- the general policy on the eligibility of nonprofit organizations
- the percentage of financing available
- the Homeownership Center (HOC) and Direct Endorsement (DE) lender responsibilities for determining eligibility
- the requirements for nonprofit approval by the Department for Housing and Urban Development (HUD)
- nonprofit organizations not meeting HUD approval requirements, and
- eligibility of state and local government agencies.

Change Date

October 26, 2009

4155.1 4.A.6.a General Policy on the Eligibility of Nonprofit Organizations

Nonprofit organizations are eligible to purchase rental properties with FHA-insured mortgages, provided that they

- intend to sell or lease the property to low- or moderate-income individuals (generally defined as income not exceeding 115 percent of the applicable median income), and
- meet the requirements for HUD approval listed in HUD 4155.1 4.A.6.d.

Nonprofit organizations may only obtain FHA-insured *fixed rate* mortgages. Only an existing FHA-insured mortgage is eligible for refinancing and may never result in equity withdrawal.

4155.1 4.A.6.b Percentage of Financing Available

Nonprofit organizations are eligible for the same percentage of financing available on owner-occupied principal residences.

Reference: For more information on the percentage of financing available, see HUD 4155.1 2.A.

Continued on next page

6. Eligibility Requirements for Nonprofit Organizations and State and Local Government Agencies, Continued

4155.1 4.A.6.c HOC and DE Lender Responsibilities for Determining Eligibility and Verifying HUD Approval

The appropriate HOC is responsible for determining a nonprofit organization's eligibility to participate in FHA programs.

The DE lender is responsible for determining

- the organization's financial capacity for repayment, and
- that the organization, at the time of underwriting, is approved by HUD as a participating nonprofit organization, as described in HUD 4155.1 4.A.6.d.

Note: Lenders can verify nonprofit approval status by visiting the HUD Web site at www.hud.gov.

4155.1 4.A.6.d Requirements for Nonprofit Approval by HUD

HUD must approve the nonprofit organization for it to be eligible to

- purchase properties with
  - FHA-insured mortgages, and
  - the same percentage of financing available to owner-occupants, and
- provide secondary financing.

In order to receive HUD approval, the nonprofit organization must

- be of the type described in Section 501(c)(3) as exempt from taxation under Section 501(a) of the Internal Revenue Code of 1986
- have a voluntary board, and no part of the net earnings of the organization or funds from the transaction may benefit any board member, founder, contributor, or individual, and
- have two years' experience as a provider of housing for low and moderate-income persons.

References: For more information on
- approved instrumentalities of government providing secondary financing, see HUD 4155.1 5.C.4, and
- *temporary* waivers of two of the above requirements for approval, see ML 09-38.

Continued on next page

6. Eligibility Requirements for Nonprofit Organizations and State and Local Government Agencies, Continued

4155.1 4.A.6.e Nonprofit Organizations Not Meeting HUD Approval Requirements

A nonprofit organization not meeting any of the requirements listed in HUD 4155.1 4.A.6.d, including religious and charitable organizations, may only purchase properties backed by FHA mortgage insurance under the conditions described for other investors in HUD 4155.1 4.A.6.b.

Note: Questions concerning a nonprofit organization's approval should be directed to the appropriate HOC.

Reference: For detailed instructions on qualifying nonprofit organizations as borrowers, including documentation requirements, see ML 02-01.

4155.1 4.A.6.f Eligibility of State and Local Government Agencies

State and local government agencies involved in the provision of housing may obtain FHA-insured financing provided that the agency provides evidence from its legal counsel that

- the agency has the legal authority to become the borrower
- the particular state or local government is not in bankruptcy, and
- there is no legal prohibition that would prevent the lender from obtaining a deficiency judgment (if permitted by State law for other types of borrowers) on FHA's behalf in the event of foreclosure or deed-in-lieu of foreclosure.

Loan applications from entities meeting the above requirements may be processed under the DE program without prior approval from the appropriate HOC.

Note: FHA does not require credit reports, financial statements, bank statements, or CAIVRS/LDP/GSA checks.

7. Eligibility for Federally Related Credit

Introduction

This topic contains information on determining eligibility for Federally-related credit, including

- the definition of the term 'Federal debt'
- basis for rejecting federally related credit
- ineligible mortgage transactions
- lender responsibility for verifying borrower eligibility
- location of federal lists
- delinquent federal debts
- waiting period for borrowers with past delinquencies and defaults
- tax liens affecting eligibility for federally-related credit, and
- how to determine creditworthiness for federally-related credit.

Change Date

March 29, 2010

4155.1 4.A.7.a Definition: Federal Debt

For a definition of the term ***Federal debt***, see HUD 4155.1 9.

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7. Eligibility for Federally Related Credit, Continued

4155.1 4.A.7.b Basis for Rejecting a Borrower for Federally Related Credit

A borrower is *not* eligible to participate in FHA-insured mortgage transactions if he/she is suspended, debarred, or otherwise excluded from participating in the HUD programs.

A lender *must* reject a borrower from participation if he/she is on the

- HUD Limited Denial of Participation (LDP) list
- U.S. General Services Administration (GSA) *List of Parties Excluded from Federal Procurement or Non-procurement Programs*, and/or
- HUD's Credit Alert Interactive Voice Response System (CAIVRS), unless an exception exists as noted in HUD 4155.1 4.A.7.c

Note: A borrower must also be rejected if he/she is presently delinquent on any Federal debt or has a lien placed against his/her property for a debt owed to the United States Government.

Reference: For information on
- delinquent Federal debt, see HUD 4155.1 4.A.7.f, and
- using CAIVRS to determine eligibility, see HUD 4155.1 4.A.8.

4155.1 4.A.7.c Ineligible Mortgage Transactions

A mortgage loan application is *not* eligible for FHA mortgage insurance if the name of any of the following parties to the mortgage transaction is found on the HUD LDP list or the GSA *List of Parties Excluded from Federal Procurement or Non-procurement Programs*:

- borrower
- seller
- listing or selling real estate agent, or
- loan officer.

Exception: A seller on the GSA list is exempt if the property being sold is the seller's principal residence.

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7. Eligibility for Federally Related Credit, Continued

4155.1 4.A.7.d Lender Responsibility for Verifying Borrower Eligibility

To determine whether a borrower is eligible to participate in an FHA mortgage loan transaction or must be rejected, the lender *must*

- examine HUD's LDP list and the GSA *List of Parties Excluded from Federal Procurement or Non-procurement Programs*, and
- document the review on the HUD-92900-LT, *FHA Loan Underwriting and Transmittal Summary*.

4155.1 4.A.7.e Location of the LDP and GSA Lists

The HUD LDP list can be found on the HUD website or on the FHA Connection.

The GSA *List of Parties Excluded from Federal Procurement and Non-Procurement Programs* can be found at http://epls.arnet.gov or on the FHA Connection.

4155.1 4.A.7.f Delinquent Federal Debts

If, after checking public records, credit information, or the Credit Alert Interactive Voice Response System (CAIVRS) a borrower is found to be presently delinquent on any Federal debt or has a lien (including taxes) placed against his/her property for a debt owed to the Federal government, he/she is *not* eligible for an FHA mortgage until

- the delinquent account is brought current, paid, or otherwise satisfied, or
- a satisfactory repayment plan is established between the borrower and the Federal agency owed and is verified in writing.

Tax liens may remain unpaid provided the lien holder subordinates the tax lien to the FHA-insured mortgage.

***Reference*:** For more information on tax liens affecting eligibility for federally related credit, HUD 4155.1 4.A.7.h.

Continued on next page

7. Eligibility for Federally Related Credit, Continued

4155.1 4.A.7.g Waiting Period for Borrowers With Past Delinquencies and Defaults

FHA has a three-year waiting period to regain eligibility for another FHA-insured mortgage when the borrower has had past delinquencies or has defaulted on an FHA-insured loan.

The three-year waiting period begins when FHA pays the initial claim to the lender. This includes deed-in-lieu of foreclosure, as well as judicial and other forms of foreclosures.

Lenders should contact the HOC having jurisdiction over the area where the property subject to default is located for information such as the

- date the claim was paid, and
- date of the initial default.

4155.1 4.A.7.h Tax Liens Affecting Eligibility for Federally Related Credit

The Internal Revenue Service (IRS) routinely takes a second lien position without the need for independent documentation. For this reason, eligibility for FHA mortgage insurance is *not* jeopardized by outstanding IRS tax liens remaining on the property, unless the lender has information that the IRS has demanded a first-lien position.

Tax liens may remain unpaid if the lien holder subordinates the tax lien to the FHA-insured mortgage.

Note: If any regular payments are to be made, they must be included in the qualifying ratios.

4155.1 4.A.7.i Consideration of a Borrower's Past Payment History on Federally Related Debt

Although a borrower's eligibility for an FHA-insured mortgage may be established by performing the actions described previously in this topic, the overall analysis of the borrower's creditworthiness must

- consider a borrower's previous failure to make payments to the Federal agency in the agreed-to manner, and
- document the lender's analysis as to how the previous failure does not represent a risk of mortgage default.

8. Using Credit Alert Interactive Voice Response System (CAIVRS) to Determine Eligibility for FHA-Insured Mortgage Transactions

Introduction

This topic contains information on using Credit Alert Interactive Voice Response System (CAIVRS) to determine a borrower's eligibility for an FHA-insured mortgage transaction, including

- a description of CAIVRS
- lender responsibility for borrower screening using CAIVRS
- documenting CAIVRS authorization
- accessing CAIVRS
- exceptions to the eligibility rule
- handling incorrect CAIVRS information, and
- lender responsibility for resolving conflicting information.

Change Date

March 29, 2010

4155.1 4.A.8.a Description of CAIVRS

The Credit Alert Interactive Voice Response System (CAIVRS) is a Federal government-wide repository of information on

- those individuals with delinquent or defaulted Federal debt, and
- those for whom a payment of an insurance claim has occurred.

4155.1 4.A.8.b Lender Responsibility for Borrower Screening Using CAIVRS

Lenders must use CAIVRS to screen all borrowers (except those involved in a streamline refinance), including nonprofit agencies acting as borrowers. The borrower is *not* eligible for Federally-related credit, if CAIVRS indicates that he/she

- is presently delinquent on a Federal debt, or
- has had a claim paid within the previous three years on a loan made and insured on his/her behalf by HUD.

Exception: Certain exceptions to this eligibility rule exist, and are described in HUD 4155.1 4.A.8.e.

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8. Using Credit Alert Interactive Voice Response System (CAIVRS) to Determine Eligibility for FHA-Insured Mortgage Transactions, Continued

4155.1 4.A.8.c Documenting CAIVRS Authorization

Lenders *must* write the CAIVRS authorization code for each borrower on Form HUD-92900-LT, *FHA Loan Underwriting and Transmittal Summary*.

4155.1 4.A.8.d Obtaining Internet Access to CAIVRS

The table below contains guidelines for FHA-approved lenders to use in order to access CAIVRS via the Internet.

Note: As of October 1, 2008, HUD discontinued telephone access to CAIVRS.

If the lender's staff …	Then …
currently *have* FHA Connection User IDs	they should request that their FHA Connection Application Coordinator update their FHA Connection profile to include CAIVRS.
does not have FHA Connection User IDs	they should • access the FHA Connection at https://entp.hud.gov/clas/index.cfm, and • select *Registering to Use the FHA Connection* to request a User ID and access to CAIVRS.

Access by Non-FHA Participating Agency Lenders: Non-FHA lender staff should

- request access from HUD's Internet site at https://entp.hud.gov/caivrs/public/home.html
- select "Registering Lender User ID" from the main menu, and·
- request at least one Application Coordinator User ID, as well as a Standard User ID for each individual user.

8. Using Credit Alert Interactive Voice Response System (CAIVRS) to Determine Eligibility for FHA-Insured Mortgage Transactions, Continued

4155.1 4.A.8.e Exceptions to the Eligibility Rule

The table below describes exceptions to the CAIVRS eligibility rule for an FHA-insured mortgage.

Exception	Description
Legal Assumptions	The borrower is eligible for an FHA-insured mortgage if he/she sold the property, with or without a release of liability, to an individual who subsequently defaulted. The borrower *must* prove that the loan was current at the time of the assumption.
Divorce	The borrower may be eligible for an FHA-insured mortgage if the divorce decree or legal separation agreement awarded the property and responsibility for payment to the former spouse. The borrower is *not* eligible if FHA paid a claim on his/her mortgage in default prior to the divorce.
Bankruptcy	The borrower *may* be eligible for an FHA-insured mortgage if • the property was included in a bankruptcy caused by circumstances beyond the borrower's control, such as the – the death of the principal wage earner, or – a serious long-term uninsured illness, and • the borrower meets the requirements described in – HUD 4155.1 4.C.2.g for Chapter 7 bankruptcy, and – HUD 4155.1 4.C.2.h for Chapter 13 bankruptcy.

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8. Using Credit Alert Interactive Voice Response System (CAIVRS) to Determine Eligibility for FHA-Insured Mortgage Transactions, Continued

4155.1 4.A.8.e Exceptions to the Eligibility Rule (continued)

Exception	Description
Seller Who Is Selling Principal Residence	A mortgage loan is generally not eligible for insurance if *any party* to the transaction is on either the • HUD Limited Denial of Participation (LDP) list, or • General Services Administration's (GSA's) "*List of Parties Excluded from Federal Procurement or Nonprocurement Programs*," However, an exception exists for a seller on the GSA list who is selling his/her principal residence**.**
Disaster Victims (in Presidentially-Declared Disaster Areas)	For information on the eligibility of disaster victims, see HUD 4155.1 6.A.6.j.

IMPORTANT: FHA does not require a *clear* CAIVRS authorization number as a condition for mortgage endorsement. However, the lender must document and justify mortgage approval based on these exceptions.

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8. Using Credit Alert Interactive Voice Response System (CAIVRS) to Determine Eligibility for FHA-Insured Mortgage Transactions, Continued

4155.1 4.A.8.f Handling Incorrect CAIVRS Information

FHA may delete erroneous CAIVRS information falsely indicating that a borrower has defaulted on an FHA mortgage, such as incorrect social security number reporting. However, FHA will *not*

- remove correct CAIVRS information, even if the borrower is judged eligible for Federally-related credit, or
- alter or delete CAIVRS information reported from other Federal agencies, such as the
  - Department of Education, or
  - Department of Veterans Affairs.

The borrower and/or lender must contact those Federal agencies directly to correct or remove erroneous or outdated information.

4155.1 4.A.8.g Lender Responsibility for Resolving Conflicting Information

Lenders may not rely on a clear CAIVRS approval when there is independent evidence of conflicting delinquent Federal obligations. The lenders must

- document the resolution of any conflicting information, and
- contact the appropriate HOC for instructions or documentation to support the borrower's eligibility if the
  - CAIVRS message seems erroneous, or
  - date of claim payment needs to be established.

The HOC may provide lenders with

- information about
  - when the three-year waiting period will elapse
  - erroneous social security numbers, and
- instructions on processing requirements for other-HUD related defaults and claims, such as Title I loans.

Section B. Property Ownership Requirements and Restrictions

Overview

In This Section

This section contains the topics listed in the table below.

1. General Information on Property Requirements and Restrictions

Introduction

This topic contains general information on property requirements and restrictions, including

- what FHA insures
- description of a condominium
- requirements for condominium eligibility
- the seven unit limitation for investors
- locating additional information on property eligibility and valuation
- manufactured housing condominium projects (MHCP), and
- requirements for site condominiums.

Change Date

March 29, 2010

4155.1 4.B.1.a What FHA Insures

Except as otherwise stated in this handbook, FHA's single family programs are limited to owner-occupied principal residences only.

Reference: For more information on what FHA will and will not insure, see HUD 4155.2 1.A.1.b.

4155.1 4.B.1.b Description of a Condominium

A condominium is a multi-unit project that

- has individually-owned units that may be either
  - attached in one or more structures, or
  - detached from each other, and
- is essentially residential in use (for FHA purposes).

A condominium regime is created by state or local law and is characterized by fee simple ownership of a unit which is defined in the condominium documents, together with common areas. The property interest in these areas is both common and undivided on the part of all unit owners, each of whom belong to the Homeowners' Association (HOA) that typically maintains the property and collects assessments or dues from each unit owner.

Reference: For more information on condominiums, see HUD 4910.1, *Minimum Property Standards for Housing*.

Continued on next page

1. General Information on Property Requirements and Restrictions, Continued

4155.1 4.B.1.c Requirements for Condominium Eligibility

FHA must approve condominium projects before a mortgage on an individual condominium unit can be insured.

Exception:
In specific circumstances, a loan on a single unit in an unapproved condominium project, known as a "spot" loan, may qualify for mortgage insurance. The lender must certify that the project satisfies the eligibility criteria for a "spot" loan condominium project that has *not* been approved by FHA.

Reference: For more information on condominiums, including condominium project approval requirements, see
- HUD 4150.2, *Valuation Analysis for Single Family One- to Four-Unit Dwellings*, and
- HUD 4265.1, *Section 234(c), Home Mortgage Insurance for Condominium Units*.

4155.1 4.B.1.d Seven Unit Limitation for Investors

Entities purchasing investment properties are limited to a financial interest in seven rental dwelling units.

Reference: For additional information on
- investment property requirements, see HUD 4155.1 4.B.4, and
- the seven unit limitation, see HUD 4155.1 4.B.4.d.

4155.1 4.B.1.e Additional Information on Property Eligibility and Valuation

For more information on property eligibility and valuation, see HUD 4155.2 4.

Continued on next page

1. General Information on Property Requirements and Restrictions, Continued

4155.1 4.B.1.f Manufactured Housing Condominium Projects (MHCP)

Individual manufactured housing units in condominium projects are eligible for FHA insurance, on both Home Equity Conversion Mortgages (HECM) and forward mortgages. All manufactured housing condominium project (MHCP) approval requests must be processed by the Homeownership Center (HOC) that has authority over the location in which the property is located.

The Spot Loan Approval process as defined in Mortgagee Letter 1996-41 is not applicable to manufactured housing in condominium projects.

MHCPs may not be processed as site condominiums.

References: For more information on
- MHCP approval, see HUD 4150.1, *Valuation Analysis for Home Mortgage Insurance*, and
- site condominiums, see 4155.1 4.B.1.g.

4155.1 4.B.1.g Site Condominiums Requirements

Site Condominiums are single family detached dwellings encumbered by a declaration of condominium covenants or condominium form of ownership.

Condominium project approval is not required for Site Condominiums; however, the Condominium Rider must be included in the FHA case binder.

Note: Manufactured housing condominium projects may not be processed as site condominiums.

2. Eligibility Requirements for Principal Residences

Introduction

This topic contains information on eligibility requirements on principal residences, including

- the definition of principal residence
- the FHA requirement for establishing owner-occupancy
- limitation on the number of FHA-insured mortgages per borrower, and
- exceptions to the FHA policy limiting the number of mortgages per borrower.

Change Date

March 29, 2010

4155.1 4.B.2.a Definition: Principal Residence

A ***principal residence*** is a property that will be occupied by the borrower for the majority of the calendar year.

4155.1 4.B.2.b FHA Requirement for Establishing Owner-Occupancy

At least one borrower must occupy the property and sign the security instrument and the mortgage note in order for the property to be considered owner-occupied.

FHA security instruments require a borrower to establish bona fide occupancy in a home as the borrower's principal residence within 60 days of signing the security instrument, with continued occupancy for at least one year.

4155.1 4.B.2.c Limitation on Number of FHA-Insured Mortgages Per Borrower

To prevent circumvention of the restrictions on FHA-insured mortgages to investors, FHA *generally* will not insure more than one principal residence mortgage for any borrower. FHA will *not* insure a mortgage if it is determined that the transaction was designed to use FHA mortgage insurance as a vehicle for obtaining investment properties, even if the property to be insured will be the *only* one owned using FHA mortgage insurance

Any person individually or jointly owning a home covered by an FHA-insured mortgage in which ownership is maintained may *not* purchase another principal residence with FHA insurance, *except* in certain situations as described in HUD 4155.1 4.B.2.d.

Exception: Properties previously acquired as investment properties are *not* subject to these restrictions.

Continued on next page

2. Eligibility Requirements for Principal Residences, Continued

4155.1 4.B.2.d Exceptions to the FHA Policy Limiting the Number of Mortgages Per Borrower

The table below describes the "exception" situations in which FHA does *not* object to borrowers obtaining multiple FHA-insured mortgages.

Note: Considerations in determining the eligibility of a borrower for one of the exceptions in the table below include the

- length of time the previous property was owned by the borrower, and
- circumstances that compel the borrower to purchase another residence with an FHA-insured mortgage.

Important: In all cases other than those listed below, the borrower is **not** eligible to acquire another FHA-insured mortgage until he/she has either

- paid off the FHA-insured mortgage on the previous residence, or
- terminated ownership of that residence.

Policy Exception	Eligibility Requirements
Relocation	A borrower may be eligible to obtain another mortgage using FHA insurance, without being required to sell an existing property covered by an FHA-insured mortgage, *if* the borrower is • relocating, and • establishing residency in an area not within reasonable commuting distance from the current principal residence. If the borrower subsequently returns to the area where he/she owns a property with an FHA-insured mortgage, he/she is *not* required to re-establish primary residency in that property in order to be eligible for another FHA-insured mortgage. ***Note***: The relocation need not be employer mandated to qualify for this exception.

Continued on next page

2. Eligibility Requirements for Principal Residences, Continued

4155.1 4.B.2.d Exceptions to the FHA Policy Limiting the Number of Mortgages Per Borrower (continued)

Policy Exception	Eligibility Requirements
Increase in family size	A borrower may be eligible for another home with an FHA-insured mortgage if the number of legal dependents increases to the point that the present house no longer meets the family's needs. The borrower must provide satisfactory evidence • of the increase in dependents and the property's failure to meet family needs, and • the LTV ratio based on the outstanding mortgage balance and a current appraisal equals 75% or less. If it does not, the borrower must pay the loan down to 75% LTV or less. ***Note***: A current residential appraisal *must* be used to determine LTV compliance. Tax assessments and market analyses by real estate brokers are *not* acceptable proof of LTV compliance.
Vacating a jointly owned property	A borrower may be eligible for another FHA-insured mortgage if he/she is vacating a residence that will remain occupied by a coborrower. ***Example***: An example of an acceptable situation is one in which there is a divorce and the vacating ex-spouse will purchase a new home.
Non-occupying coborrower	A borrower may be qualified for an FHA-insured mortgage on his/her own principal residence even if he/she is a non-occupying coborrower with a joint interest in a property being purchased by other family members as a principal residence with an FHA-insured mortgage.

Important: Under *no* circumstances may investors use the exceptions described in the table above to circumvent FHA's ban on loans to private investors and acquire rental properties through purportedly purchasing "principal residences."

3. Eligibility Requirements for Secondary Residences

Introduction

This topic contains information on eligibility requirements for secondary residences, including

- a definition of secondary residence
- the requirement for a HOC determination of undue hardship
- requesting a hardship exception
- limitation on the number of secondary residences, and
- secondary residence requirements.

Change Date

March 29, 2010

4155.1 4.B.3.a Definition: Secondary Residence

A ***secondary residence*** is a property that a borrower occupies in addition to his/her principal residence.

4155.1 4.B.3.b Requirement for HOC Determination of Undue Hardship

Secondary residences are *only* permitted when

- the appropriate HOC agrees that an undue hardship exists, meaning that affordable rental housing that meets the needs of the family is not available for lease in the area or within reasonable commuting distance of work, and
- the maximum loan amount is 85 percent of the *lesser* of the appraised value or sales price.

Note: DE lenders are *not* authorized to grant hardship exceptions. Only the HOC may make the determination that an undue hardship exists.

4155.1 4.B.3.c Requesting a Hardship Exception

Any request for a hardship exception must be submitted, in writing, by the lender to the appropriate HOC.

Reference: For information on HOC jurisdictions, see HUD 4155.1 8.1.

Continued on next page

3. Eligibility Requirements for Secondary Residences,
Continued

4155.1 4.B.3.d Limitation on the Number of Secondary Residences

A borrower may have only *one* secondary residence at any time.

4155.1 4.B.3.e Requirements for Secondary Residences

Secondary residences must meet all of the following requirements:

- the secondary residence must *not* be a vacation home or be otherwise used primarily for recreational purposes
- the borrower must obtain the secondary residence because of seasonal employment, employment relocation, or other circumstances not related to recreational use of the residence, and
- there must be a demonstrated lack of affordable rental housing meeting the needs of the borrower in the area or within a reasonable commuting distance of the borrower's employment, and the borrower must provide supporting documentation of this, including
  - a satisfactory explanation by the borrower of the need for a secondary residence and the lack of available rental housing, and
  - written evidence from local real estate professionals who verify a lack of acceptable housing in the area.

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4. Investment Property Eligibility and Underwriting Requirements

Introduction

This topic contains information on eligible investment properties, including

- a definition of investment property
- loan transactions in which an investor may obtain an FHA-insured mortgage
- underwriting considerations on investment properties
- seven unit-limitation on investment properties, and
- restriction on investment properties for hotel and transient use.

Change Date

March 29, 2010

4155.1 4.B.4.a Definition: Investment Property

An ***investment property*** is a property that is *not* occupied by the borrower as a principal or secondary residence.

4155.1 4.B.4.b Loan Transactions in Which a Private Investor May Obtain an FHA-Insured Mortgage

With permission from the appropriate HOC, private investors, including nonprofit organizations that do *not* meet the criteria described in HUD 4155.1 4.A.6.a, may obtain an FHA-insured mortgage when

- purchasing HUD Real Estate Owned (REO) properties, or
- obtaining a streamline refinance without an appraisal.

Note: In HUD REO transactions, owner occupancy is not required when the jurisdictional HOC sells the property and permits the purchaser to obtain FHA-insured financing on the investment property.

Reference: For additional qualifying information on streamline refinances without an appraisal, see HUD 4155.1.3.C.2.

Continued on next page

4. Investment Property Eligibility and Underwriting Requirements, Continued

4155.1 4.B.4.c Underwriting Considerations on Investment Properties

Underwriting considerations on investment properties are listed below.

- Individual investors who credit qualify may assume mortgages made on investment properties. This applies to the transactions described in HUD 4155.1 4.B.4.b, as well as to investment properties purchased before the 1989 ban on investors that have been subsequently streamline refinanced.
- Underwriting considerations regarding such issues as qualifying ratios and the treatment of projected rental income are described in HUD 4155.1.4.E.4.
- Adjustable rate mortgages (ARMs) and graduated payment mortgages (GPMs) are *not* permitted on investment properties.
- For investment properties, FHA will not insure loans made solely in the name of a business entity (such as a corporation, partnership, or sole proprietorship), *except* for streamline refinances in which the mortgage was originally insured in the name of a business. Additionally, FHA requires that
  - one or more individuals, along with the business entity or trust, must be analyzed for creditworthiness
  - the individual(s) and business entity or trust must appear on the mortgage note, and
  - if all parties appear on the property deed or title, they must also appear on the security instrument (such as the mortgage, deed of trust, or security deed).
- For purchases of HUD REO properties, owner occupancy is *not* required when the jurisdictional HOC sells the property and permits the purchaser to obtain FHA-insured financing on the investment property.
- Streamline refinancing without an appraisal is permitted on investment properties.
- Base mortgage calculation is 75% LTV applied to the lesser of the appraised value or the sales price.

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4. Investment Property Eligibility and Underwriting Requirements, Continued

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4155.1 4.B.4.d Seven Unit Limitation for Investors

Qualified investor entities are limited to a financial interest (that is, any type of ownership, regardless of the type of financing) in seven rental dwelling units, when the subject property is part of, adjacent to, or contiguous to, a property, subdivision or group of properties owned by the investor.

The units that count toward this limitation include

- *each* dwelling unit in a two, three, and four family property, and
- the rental units in an owner-occupied two, three, or four unit property.

Notes:
- The lender is responsible for ensuring compliance with this regulation.
- Waivers to the seven unit limitation can only be initiated by the jurisdictional HOC for good cause.

4155.1 4.B.4.e Restriction on Investment Properties for Hotel and Transient Use

Investors must assure FHA that investment properties purchased will not be used for hotel or transient purposes, or otherwise rented for periods of less than 30 days.

Completion of Form HUD 92561, *Hotel and Transient Use Certification*, provides this assurance and is required on every application for

- two, three, or four family dwellings, and
- single family dwellings that are one of a group of five or more dwellings held by the same borrower.

Section C. Borrower Credit Analysis

Overview

In This Section

This section contains the topics listed in the table below.

1. General Guidelines for Analyzing Borrower Credit

Introduction

This topic contains information on the general guidelines for analyzing borrower credit, including

- past credit performance
- analyzing credit history
- documenting analysis of delinquent accounts
- developing a credit history
- documenting non-traditional credit providers, and
- non-traditional mortgage credit report.

Change Date

March 29, 2010

4155.1 4.C.1.a Past Credit Performance

Past credit performance is the most useful guide to use when

- determining a borrower's attitude toward credit obligations, and
- predicting a borrower's future actions.

Borrowers who have made payments on previous and current obligations in a timely manner represent a reduced risk. Conversely, if a borrower's credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, significant compensating factors will be necessary to approve the loan.

4155.1 4.C.1.b Analyzing Credit History

When analyzing a borrower's credit history, examine the overall pattern of credit behavior, not just isolated occurrences of unsatisfactory or slow payments.

A period of past financial difficulty does not necessarily make the risk unacceptable, if the borrower has maintained a good payment record for a considerable time period since the financial difficulty.

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1. General Guidelines for Analyzing Borrower Credit, Continued

4155.1 4.C.1.c Documenting an Analysis of Delinquent Accounts

The lender *must* document the analysis of delinquent accounts, including whether late payments were based on

- a disregard for financial obligations
- an inability to manage debt, or
- factors beyond the borrower's control, such as
  - – delayed mail delivery, or
  - – disputes with creditors.

Minor derogatory information occurring two or more years in the past does not require an explanation. Major indications of derogatory credit, such as judgments, collections, and other recent credit problems, require sufficient written explanation from the borrower. The explanation must make sense, and be consistent with other credit information in the file.

TOTAL Scorecard Accept/Refer Recommendation
The TOTAL Scorecard Accept recommendation does not require an explanation for adverse credit, or other derogatory information; however, there must be evidence of payoff for any outstanding judgments shown on the credit report.

The TOTAL Scorecard Refer recommendation requires an explanation for major indications of derogatory credit, such as

- judgments and collections, and
- any minor indications within the past two years.

Reference: For more information on the TOTAL Scorecard recommendations, see Pages 18 & 19 of the *TOTAL Mortgage Scorecard User Guide at* http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm.

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1. General Guidelines for Analyzing Borrower Credit, Continued

4155.1 4.C.1.d Developing a Credit History

The lack of a credit history, or the borrower's decision to not use credit, may *not* be used as the basis for rejecting the loan application.

Some prospective borrowers may not have an established credit history. For these borrowers, including those who do not use traditional credit, the lender must obtain a non traditional merged credit report (NTMCR) from a credit reporting company or develop a credit history from

- utility payment records
- rental payments
- automobile insurance payments, and
- other means of direct access from the credit provider.

TOTAL Scorecard Accept Recommendation
If TOTAL Scorecard has issued an Accept recommendation, additional development of credit history is *not* required.

Reference: For more information on the TOTAL Scorecard recommendations, see the *TOTAL Mortgage Scorecard User* Guide at http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm.

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1. General Guidelines for Analyzing Borrower Credit, Continued

4155.1 4.C.1.e Verifying and Documenting Non Traditional Credit Providers

Only if a NTMCR does not exist or such a service is unavailable may a lender choose to obtain independent verification of credit references. Lenders must document that the providers of non traditional credit do exist, and verify the credit information. Documents confirming the existence of a non traditional credit provider may include

- public records from the state, county, or city, or
- other documents providing a similar level of objective information.

To verify credit information, lenders must use a published address or telephone number for the credit provider and not rely solely on information provided by the applicant.

Rental references from management companies with payment history for the most recent 12 months may be used in lieu of 12 months cancelled checks. Credit references may also be developed via independent verification directly to the creditor. If a method other than NTMCR is used to verify credit information or rental references, all references obtained from individuals should be backed up with the most recent 12 months cancelled checks

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1. General Guidelines for Analyzing Borrower Credit, Continued

4155.1 4.C.1.f Non Traditional Mortgage Credit Report

Lenders may use a non traditional mortgage credit report developed by a credit reporting agency as an alternative method for developing a credit history. Use of this type of report requires that the credit reporting agency has verified

- the existence of the credit providers
- that the non-traditional credit was actually extended to the borrower, and the creditor has a published address or telephone number.

Reference: For more information on non traditional credit reports, see HUD 4155.1 1.7.

2. Guidelines for Credit Report Review

Introduction

This topic contains information on the credit report items for lenders to review, including

- the hierarchy of credit review
- the review of previous rental or mortgage payment history
- recent and/or undisclosed debts and inquiries
- collections and judgments
- paying off collections and judgments
- previous mortgage foreclosure
- Chapter 7 bankruptcy
- Chapter 13 bankruptcy
- consumer credit counseling payment plans
- use of truncated SSNs on credit reports, and
- a reference for information on evaluating non-traditional/insufficient credit.

Change Date

March 29, 2010

4155.1 4.C.2.a Hierarchy of Credit Review

The basic hierarchy for evaluating credit involves reviewing how payments were made on the following:

- previous housing expenses, including utilities, then
- payment history on installment debts, then
- payment history on revolving accounts.

Generally, a borrower is considered to have an acceptable credit history if he/she does not have late housing or installment debt payments, unless there is major derogatory credit on his/her revolving accounts.

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2. Guidelines for Credit Report Review, Continued

4155.1 4.C.2.b Reviewing Previous Rental or Mortgage Payment History

The borrower's housing obligation payment history holds significant importance when evaluating credit. The lender must determine the borrower's housing obligation payment history through the

- credit report
- verification of rent directly from the landlord (for landlords with no identity-of-interest with the borrower)
- verification of the mortgage directly from the mortgage servicer, or
- the review of canceled checks that cover the most recent 12-month period.

Note: The lender must verify/document the previous 12 months housing history even if the borrower states he/she is living rent free.

TOTAL Scorecard Accept Recommendation
Waive the housing/rental history requirement.

Reference: For more information on the TOTAL Scorecard recommendations, see the *TOTAL Mortgage Scorecard User Guide* at http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm.

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2. Guidelines for Credit Report Review, Continued

4155.1 4.C.2.c Recent and/ or Undisclosed Debts and Inquiries

Lenders *must* determine the purpose of any recent debts as the indebtedness may have been incurred to obtain the required cash investment.

A borrower *must* provide a satisfactory explanation for any significant debt that is shown on the credit report, but not listed on the loan application. Written explanation is required for all inquiries shown on the credit report for the last 90 days.

TOTAL Scorecard Accept Recommendation

- Verify the actual monthly payment amount.
- Include the monthly payment amount and resubmit the loan if the liability is greater than $100 per month.
- Determine that any funds borrowed were not/will not be used for the homebuyer's cash investment in the transaction.

Note: Explanation is not required for inquiries.

Reference: For more information on the TOTAL Scorecard recommendations, see Page 17 of the *TOTAL Mortgage Scorecard User Guide* at http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm.

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2. Guidelines for Credit Report Review, Continued

4155.1 4.C.2.d Collections and Judgments

Collections and judgments indicate a borrower's regard for credit obligations, and *must* be considered in the creditworthiness analysis.

The lender must document reasons for approving a mortgage when the borrower has collection accounts or judgments. The borrower *must* explain, in writing, all collections and judgments.

Note: Compliance with the requirements specified in HUD 4155.1 4.C.2.e is applicable to judgments.

TOTAL Scorecard Accept Recommendation
Collection accounts trigger neither an explanation requirement nor a hypothetical monthly payment to be used in qualifying borrowers. The presence of collection accounts in the borrower's credit history already result in lowering the credit bureau scores used in TOTAL and, thus, no further information need be provided by the borrower.

References: For information on

- paying off collections and judgments, see HUD 4155.1 4.C.2.e and
- the TOTAL Scorecard recommendations, see the *TOTAL Mortgage Scorecard User Guide* at http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm.

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2. Guidelines for Credit Report Review, Continued

4155.1 4.C.2.e Paying off Collections and Judgments

FHA does *not* require that collection accounts be paid off as a condition of mortgage approval. However, court-ordered judgments *must* be paid off before the mortgage loan is eligible for FHA insurance endorsement.

Exception: An exception on a court-ordered judgment may be made if the borrower

- has an agreement with the creditor to make regular and timely payments, and
- has provided documentation indicating that payments have been made according to the agreement.

TOTAL Scorecard Accept/Refer Recommendation
TOTAL Scorecard Accept and Refer recommendations require that the lender obtain evidence of payoff for any outstanding judgments shown on the credit report.

Reference: For more information on the TOTAL Scorecard recommendations, see Page 18 of the *TOTAL Mortgage Scorecard User Guide* at http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm.

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2. Guidelines for Credit Report Review, Continued

4155.1 4.C.2.f Previous Mortgage Foreclosure

A borrower is generally *not* eligible for a new FHA-insured mortgage when, during the previous three years

- his/her previous principal residence or other real property was foreclosed, or
- he/she has given a deed-in-lieu of foreclosure.

Exception: The lender may grant an exception to the three-year requirement if the foreclosure was the result of documented extenuating circumstances that were beyond the control of the borrower, such as a serious illness or death of a wage earner, and the borrower has re-established good credit since the foreclosure. Divorce is *not* considered an extenuating circumstance. However, the situation in which a borrower whose loan was current at the time of a divorce in which the ex-spouse received the property and the loan was later foreclosed qualifies as an exception.

Note: The inability to sell the property due to a job transfer or relocation to another area does not qualify as an extenuating circumstance.

4155.1 4.C.2.g Chapter 7 Bankruptcy

A Chapter 7 bankruptcy (liquidation) does not disqualify a borrower from obtaining an FHA-insured mortgage, if at least two years have elapsed since the date of the discharge of the bankruptcy. During this time, the borrower must

- have reestablished good credit, or
- chosen not to incur new credit obligations.

An elapsed period of less than two years, but not less than 12 months may be acceptable for an FHA-insured mortgage, if the borrower

- can show that the bankruptcy was caused by extenuating circumstances beyond his/her control, and
- has since exhibited a documented ability to manage his/her financial affairs in a responsible manner.

Note: The lender must document that the borrower’s current situation indicates that the events that led to the bankruptcy are not likely to recur.

Continued on next page

2. Guidelines for Credit Report Review, Continued

4155.1 4.C.2.h Chapter 13 Bankruptcy

A Chapter 13 bankruptcy does not disqualify a borrower from obtaining an FHA-insured mortgage, provided that the lender documents that

- one year of the payout period under the bankruptcy has elapsed, and
- the borrower's payment performance has been satisfactory and all required payments have been made on time.

The borrower *must* receive written permission from the court to enter into the mortgage transaction.

TOTAL Scorecard Accept Recommendation
Lender documentation must show two years from the discharge date of a Chapter 13 bankruptcy.
If the Chapter 13 bankruptcy has not been discharged for a minimum period of 2 years, the loan must be downgraded to a Refer and be evaluated by a Direct Endorsement (DE) underwriter.

Reference: For more information on the TOTAL Scorecard recommendations, see the *TOTAL Mortgage Scorecard User Guide* at http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm.

4155.1 4.C.2.i Consumer Credit Counseling Payment Plans

Participating in a consumer credit counseling program does not disqualify a borrower from obtaining an FHA mortgage, provided the lender documents that

- one year of the pay-out period has elapsed under the plan, and
- the borrower's payment performance has been satisfactory and all required payments have been made on time.

The borrower *must* receive written permission from the counseling agency to enter into the mortgage transaction.

TOTAL Scorecard Accept Recommendation
The borrower's decision to participate in consumer credit counseling does not trigger a requirement for additional documentation since the credit scores already reflect the degradation in credit history. The borrower's credit history, not voluntary participation in consumer credit counseling, is the important variable in scoring the mortgage and, thus, no explanation or other documentation is needed.

Reference: For more information on the TOTAL Scorecard recommendations, see the *TOTAL Mortgage Scorecard User Guide* at http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm.

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2. Guidelines for Credit Report Review, Continued

4155.1 4.C.2.j Use of Truncated SSNs on Credit Reports

In an effort to reduce the risk of identity theft and other forms of financial fraud, some providers of consumer credit reports have begun using a truncated version of an individual's Social Security Number (SSN) on the credit report product that is offered.

A truncated SSN, that contains as few as the last four digits of a borrower's full number, is acceptable for FHA mortgage insurance purposes provided that

- the loan application captures the full 9-digit SSN, and
- the borrower's name, SSN and date of birth are validated through the FHA Connection or its functional equivalent.

4155.1 4.C.2.k Evaluating Non Traditional/ Insufficient Credit Reference

For guidelines for evaluating borrowers with non traditional or insufficient credit histories, see HUD 4155.1 4.C.3.

3. Evaluating Non Traditional Credit and Insufficient Credit

Introduction

This topic contains information on

- evaluating borrowers with
  - non traditional credit histories, and
  - insufficient credit histories, and
- underwriting guidance for borrowers with insufficient credit histories.

Change Date

March 29, 2010

4155.1 4.C.3.a Evaluating Non Traditional Credit

When evaluating borrowers with non traditional credit histories, a satisfactory credit history, at least 12 months in duration, must include:

- no history of delinquency on rental housing payments
- no more than one 30-day delinquency on payments due to other creditors, and
- no collection accounts/court records reporting (other than medical) filed within the past 12 months.

4155.1 4.C.3.b Evaluating Borrowers With Insufficient Credit

When evaluating borrowers with no credit references, or otherwise having only Group II references as outlined in HUD 4155.1 1.7.f, a satisfactory credit history, at least 12 months in duration, must include:

- no more than one 30-day delinquency on payments due to any Group II reference, and
- no collection accounts/court records reporting (other than medical) filed within the past 12 months.

Continued on next page

3. Evaluating Non Traditional Credit and Insufficient Credit, Continued

4155.1 4.C.3.c Underwriting Guidance for Borrowers With Insufficient Credit

In order to enhance the likelihood of homeownership sustainability for borrowers with insufficient credit histories, the underwriting guidance below is provided.

- Qualifying ratios are to be computed *only* on those occupying the property and obligated on the loan, and may not exceed 31 percent for the payment-to-income ratio and 43 percent for the total debt-to-income ratio. Compensating factors are not applicable for borrowers with insufficient credit references.
- Borrowers should have two months of cash reserves following mortgage loan settlement from their own funds (no cash gifts from any source should be counted in the cash reserves for borrowers in this category).

Reference: For more information on the restriction on the addition of non occupant co borrowers for credit underwriting, see HUD 4155.1 3.B.2.c.

4. Borrower Liabilities: Recurring Obligations

Introduction

This topic contains information on borrower recurring obligations, including

- types of recurring obligations
- debt to income ratio computation for recurring obligations
- revolving account monthly payment calculation, and
- reduction of alimony payments for qualifying ratio calculation.

Change Date

March 29, 2010

4155.1 4.C.4.a Types of Recurring Obligations

Recurring obligations include

- all installment loans
- revolving charge accounts
- real estate loans
- alimony
- child support, and
- other continuing obligations.

Continued on next page

4. Borrower Liabilities: Recurring Obligations, Continued

4155.1 4.C.4.b Debt to Income Ratio Computation for Recurring Obligations

The lender must include the following when computing the debt to income ratios for recurring obligations:

- monthly housing expense, and
- additional recurring charges extending ten months or more, such as
  - payments on installment accounts
  - child support or separate maintenance payments
  - revolving accounts, and
  - alimony.

Debts lasting *less* than ten months *must* be included if the amount of the debt affects the borrower's ability to pay the mortgage during the months immediately after loan closing, especially if the borrower will have limited or no cash assets after loan closing.

Note**:** Monthly payments on revolving or open-ended accounts, regardless of the balance, are counted as a liability for qualifying purposes even if the account appears likely to be paid off within 10 months or less.

Continued on next page

4. Borrower Liabilities: Recurring Obligations, Continued

4155.1 4.C.4.c Revolving Account Monthly Payment Calculation

If the credit report shows any revolving accounts with an outstanding balance but no specific minimum monthly payment, the payment must be calculated as the greater of

- 5 percent of the balance, or
- $10.

Note: If the actual monthly payment is documented from the creditor or the lender obtains a copy of the current statement reflecting the monthly payment, that amount may be used for qualifying purposes.

4155.1 4.C.4.d Reduction of Alimony Payment for Qualifying Ratio Calculation

Since there are tax consequences of alimony payments, the lender may choose to treat the monthly alimony obligation as a reduction from the borrower's gross income when calculating qualifying ratios, rather than treating it as a monthly obligation.

5. Borrower Liabilities: Contingent Liability

Introduction

This topic contains information on borrower contingent liabilities, including

- the definition of the term ‘contingent liability’
- application of contingent liability policies
- contingent liability on mortgage assumptions
- exemption from contingent liability policy on mortgage assumptions, and
- contingent liability on cosigned obligations.

Change Date

March 29, 2010

4155.1 4.C.5.a Definition: Contingent Liability

A ***contingent liability*** exists when an individual is held responsible for payment of a debt if another party, jointly or severally obligated, defaults on the payment.

4155.1 4.C.5.b Application of Contingent Liability Policies

The contingent liability policies described in this topic apply *unless* the borrower can provide conclusive evidence from the debt holder that there is no possibility that the debt holder will pursue debt collection against him/her should the other party default.

4155.1 4.C.5.c Contingent Liability on Mortgage Assumptions

Contingent liability must be considered when the borrower remains obligated on an outstanding FHA-insured, VA-guaranteed, or conventional mortgage secured by property that

- has been sold or traded within the last 12 months without a release of liability, or
- is to be sold on assumption *without* a release of liability being obtained.

Continued on next page

5. Borrower Liabilities: Contingent Liability, Continued

4155.1 4.C.5.d Exemption From Contingent Liability Policy on Mortgage Assumptions

When a mortgage is assumed, contingent liabilities need not be considered *if*

- the originating lender of the mortgage being underwritten obtains, from the servicer of the assumed loan, a payment history showing that the mortgage has been current during the previous 12 months, or
- the value of the property, as established by an appraisal or the sales price on the HUD-1 Settlement Statement from the sale of the property, minus the Up-Front Mortgage Insurance Premium (UFMIP) results in an LTV of 75% or less.

TOTAL Scorecard Accept Recommendation
Obtain either

- a copy of the divorce decree ordering the spouse to make payments, or
- the assumption agreement and deed showing transfer of title out of the borrower's name. (***Note***: A 12-month history is *not* required.)

Reference: For more information on the TOTAL Scorecard recommendations, see the *TOTAL Mortgage Scorecard User Guide* at http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm.

4155.1 4.C.5.e Contingent Liability on Cosigned Obligations

Contingent liability applies, and the debt must be included in the underwriting analysis, if an individual applying for an FHA-insured mortgage is a cosigner/co-obligor on a

- car loan
- student loan
- mortgage, or
- any other obligation.

If the lender obtains documented proof that the primary obligor has been making regular payments during the previous 12 months, and does not have a history of delinquent payments on the loan during that time, the payment does not have to be included in the borrower's monthly obligations.

6. Borrower Liabilities: Projected Obligations and Obligations Not Considered Debt

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Introduction

This topic contains information on borrower

- projected obligations, and
- obligations not considered debt.

Change Date

March 29, 2010

4155.1 4.C.6.a Projected Obligations

Debt payments, such as a student loan or balloon note scheduled to begin or come due within 12 months of the mortgage loan closing, must be included by the lender as anticipated monthly obligations during the underwriting analysis.

Debt payments do *not* have to be classified as projected obligations if the borrower provides written evidence that the debt will be deferred to a period outside the 12-month timeframe.

Balloon notes that come due within one year of loan closing must be considered in the underwriting analysis.

4155.1 4.C.6.b Obligations Not Considered Debt

Obligations not considered debt, and therefore not subtracted from gross income, include

- Federal, state, and local taxes
- Federal Insurance Contributions Act (FICA) or other retirement contributions, such as 401(k) accounts (including repayment of debt secured by these funds)
- commuting costs
- union dues
- open accounts with zero balances
- automatic deductions to savings accounts
- child care, and
- voluntary deductions.

Section D. Borrower Employment and Employment Related Income

Overview

In This Section

This section contains the topics listed in the table below.

1. Stability of Income

Introduction

This topic contains information on determining a borrower's income stability, including

- determining effective income
- verifying employment history
- analyzing a borrower's employment record, and
- addressing a borrower's returning to work after an extended absence.

Change Date

March 29, 2010

4155.1 4.D.1.a Effective Income

Income may not be used in calculating the borrower's income ratios if it comes from any source that cannot be verified, is not stable, or will not continue.

Continued on next page

1. Stability of Income, Continued

4155.1 4.D.1.b Verifying Employment History

To be eligible for a mortgage, FHA does not require a minimum length of time that a borrower must have held a position of employment. However, the lender must verify the borrower's employment for the most recent two full years, and the borrower must

- explain any gaps in employment that span one or more months, and
- indicate if he/she was in school or the military for the recent two full years, providing evidence supporting this claim, such as
  - college transcripts, or
  - discharge papers.

Allowances can be made for seasonal employment, typical for the building trades and agriculture, if documented by the lender.

TOTAL Scorecard Accept Recommendation
The TOTAL Scorecard Accept recommendation does not require an explanation for gaps in employment of six months or less, during the most recent two years.

Note: A borrower with a 25 percent or greater ownership interest in a business is considered self employed and will be evaluated as a self employed borrower for underwriting purposes.

References: For more information on

- seasonal employment, see HUD 4155.1 4.D.2.e
- self employed borrowers and income analysis, see HUD 4155.1 4.D.4, and
- the TOTAL Scorecard recommendations, see the *TOTAL Mortgage Scorecard User Guide at* http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm.

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1. Stability of Income, Continued

4155.1 4.D.1.c Analyzing a Borrower's Employment Record

When analyzing the probability of continued employment, lenders must examine

- the borrower's past employment record
- qualifications for the position
- previous training and education, and
- the employer's confirmation of continued employment.

Favorably consider a borrower for a mortgage if he/she changes jobs frequently within the same line of work, but continues to advance in income or benefits. In this analysis, income stability takes precedence over job stability.

4155.1 4.D.1.d Borrowers Returning to Work After an Extended Absence

A borrower's income may be considered effective and stable when recently returning to work after an extended absence if he/she

- is employed in the current job for six months or longer, and
- can document a two year work history prior to an absence from employment using
  - – traditional employment verifications, and/or
  - – copies of W-2 forms or pay stubs.

Note: An acceptable employment situation includes individuals who took several years off from employment to raise children, then returned to the workforce.

Important: Situations not meeting the criteria listed above may *only* be considered as compensating factors. Extended absence is defined as six months.

2. Salary, Wage and Other Forms of Income

Introduction

This topic contains information on qualifying a borrower using salary, wage, and other forms of income, including

- general policy on borrower income analysis
- overtime and bonus income
- overtime and bonus income earning trend
- qualifying part-time income
- income from seasonal employment
- primary employment less than 40 hour work week
- commission income
- qualifying commission income earned for less than one year
- employer differential payments
- retirement income
- Social Security income, and
- automobile allowances and expense account payments.

Change Date

March 29, 2010

4155.1 4.D.2.a General Policy on Borrower Income Analysis

The income of each borrower who will be obligated for the mortgage debt *must* be analyzed to determine whether his/her income level can be reasonably expected to continue through at least the first three years of the mortgage loan.

In most cases, a borrower's income is limited to salaries or wages. Income from other sources can be considered as effective, when properly verified and documented by the lender.

Notes:

- Effective income for borrowers planning to retire during the first three-year period *must* include the amount of
  - documented retirement benefits
  - Social Security payments, or
  - other payments expected to be received in retirement.
- Lenders *must not* ask the borrower about possible, future maternity leave.

Continued on next page

2. Salary, Wage and Other Forms of Income, Continued

4155.1 4.D.2.b Overtime and Bonus Income

Overtime and bonus income can be used to qualify the borrower if he/she has received this income for the past two years, and it will likely continue. If the employment verification states that the overtime and bonus income is unlikely to continue, it may not be used in qualifying.

The lender must develop an average of bonus or overtime income for the past two years. Periods of overtime and bonus income less than two years may be acceptable, provided the lender can justify and document in writing the reason for using the income for qualifying purposes.

4155.1 4.D.2.c Establishing an Overtime and Bonus Income Earning Trend

The lender *must* establish and document an earnings trend for overtime and bonus income. If either type of income shows a continual decline, the lender *must* document in writing a sound rationalization for including the income when qualifying the borrower.

A period of more than two years must be used in calculating the average overtime and bonus income if the income varies significantly from year to year.

Continued on next page

2. Salary, Wage and Other Forms of Income, Continued

4155.1 4.D.2.d Qualifying Part-Time Income

Part-time and seasonal income can be used to qualify the borrower if the lender documents that the borrower has worked the part-time job uninterrupted for the past two years, and plans to continue. Many low and moderate income families rely on part-time and seasonal income for day to day needs, and lenders should not restrict consideration of such income when qualifying these borrowers.

Part-time income received for less than two years may be included as effective income, provided that the lender justifies and documents that the income is likely to continue.

Part-time income not meeting the qualifying requirements may be considered as a compensating factor only.

Note: For qualifying purposes, "part-time" income refers to employment taken to supplement the borrower's income from regular employment; part-time employment is not a primary job and it is worked less than 40 hours.

4155.1 4.D.2.e Income From Seasonal Employment

Seasonal income is considered uninterrupted, and may be used to qualify the borrower, if the lender documents that the borrower

- has worked the same job for the past two years, and
- expects to be rehired the next season.

Seasonal employment includes
- umpiring baseball games in the summer, or
- working at a department store during the holiday shopping season.

Continued on next page

2. Salary, Wage and Other Forms of Income, Continued

4155.1 4.D.2.f Primary Employment Less Than 40 Hour Work Week

When a borrower's primary employment is less than a typical 40-hour work week, the lender should evaluate the stability of that income as regular, on-going primary employment.

Example: A registered nurse may have worked 24 hours per week for the last year. Although this job is less than the 40-hour work week, it is the borrower's primary employment, and should be considered effective income.

4155.1 4.D.2.g Commission Income

Commission income *must* be averaged over the previous two years. To qualify commission income, the borrower must provide

- copies of signed tax returns for the last two years, and
- the most recent pay stub.

Commission income showing a decrease from one year to the next requires significant compensating factors before a borrower can be approved for the loan.

Borrowers whose commission income was received for more than one year, but less than two years may be considered favorably if the underwriter can

- document the likelihood that the income will continue, and
- soundly rationalize accepting the commission income.

Notes:
- Unreimbursed business expenses must be subtracted from gross income.
- A commissioned borrower is one who receives more than 25 percent of his/her annual income from commissions.
- A tax transcript obtained directly from the IRS may be used in lieu of signed tax returns, and the cost of the transcript may be charged to the borrower.

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2. Salary, Wage and Other Forms of Income, Continued

4155.1 4.D.2.h Qualifying Commission Income Earned for Less Than One Year

Commission income earned for less than one year is *not* considered effective income. Exceptions may be made for situations in which the borrower's compensation was changed from salary to commission within a similar position with the same employer.

A borrower may also qualify when the portion of earnings *not* attributed to commissions would be sufficient to qualify the borrower for the mortgage.

4155.1 4.D.2.i Employer Differential Payments

If the employer subsidizes a borrower's mortgage payment through direct payments, the amount of the payments

- is considered gross income, and
- cannot be used to offset the mortgage payment directly, even if the employer pays the servicing lender directly.

4155.1 4.D.2.j Retirement Income

Retirement income must be verified from the former employer, or from Federal tax returns. If any retirement income, such as employer pensions or 401(k)s, will cease within the first full three years of the mortgage loan, the income may *only* be considered as a compensating factor.

4155.1 4.D.2.k Social Security Income

Social Security income must be verified by the Social Security Administration or on Federal tax returns. If any benefits expire within the first full three years of the loan, the income source may be considered *only* as a compensating factor.

Notes:
- The lender must obtain a complete copy of the current awards letter.
- Not all Social Security income is for retirement-aged recipients; therefore, documented continuation is required.
- Some portion of Social Security income may be "grossed up" if deemed nontaxable by the IRS

Reference: For information on "grossing up" income, see HUD 4155.1.4.E.5.b.

Continued on next page

2. Salary, Wage and Other Forms of Income, Continued

4155.1 4.D.2.l Automobile Allowances and Expense Account Payments

Only the amount by which the borrower's automobile allowance or expense account payments *exceed* actual expenditures may be considered income.

To establish the amount to add to gross income, the borrower must provide the following:

- IRS Form 2106, *Employee Business Expenses*, for the previous two years, and
- employer verification that the payments will continue.

If the borrower uses the standard per-mile rate in calculating automobile expenses, as opposed to the actual cost method, the portion that the IRS considers depreciation may be added back to income.

Expenses that must be treated as recurring debt include

- the borrower's monthly car payment, and
- any loss resulting from the calculation of the difference between the actual expenditures and the expense account allowance.

3. Borrowers Employed by a Family Owned Business

Change Date	March 29, 2010
4155.1 4.D.3.a Income Documentation Requirement	In addition to normal employment verification, a borrower employed by a family owned businesses are required to provide evidence that he/she is not an owner of the business, which may include • copies of signed personal tax returns, or • a signed copy of the corporate tax return showing ownership percentage. ***Note***: A tax transcript obtained directly from the IRS may be used in lieu of signed tax returns, and the cost of the transcript may be charged to the borrower

4. General Information on Self Employed Borrowers and Income Analysis

Introduction

This topic contains general information on self employed borrowers and the analysis of self employed borrower income, including

- the definition of the term 'self employed'
- types of business structures
- the minimum length of self employment
- general documentation requirements for self employed borrowers
- establishing a borrower's earnings trend
- profit and loss TOTAL Scorecard Accept/Refer requirements, and
- analyzing a business's financial strength.

Change Date

March 29, 2010

4155.1 4.D.4.a Definition: Self Employed Borrower

A borrower with a 25 percent or greater ownership interest in a business is considered self employed for FHA loan underwriting purposes.

4155.1 4.D.4.b Types of Business Structures

There are four basic types of business structures. They include

- sole proprietorships
- corporations
- limited liability or "S" corporations, and
- partnerships.

Reference: For more information on analyzing income for

- sole proprietorships, see HUD 4155.1 4.D.5
- corporations, see HUD 4155.1 4.D.6
- "S" corporations, see HUD 4155.1 4..D.7, and
- partnerships, see HUD 4155.1 4.D.8.

Continued on next page

4. General Information on Self Employed Borrowers and Income Analysis, Continued

4155.1 4.D.4.c Minimum Length of Self Employment

Income from self employment is considered stable, and effective, if the borrower has been self employed for two or more years.

Due to the high probability of failure during the first few years of a business, the requirements described in the table below are necessary for borrowers who have been self employed for less than two years.

If the period of self employment is ...	Then ...
between one and two years	to be eligible for a mortgage loan, the individual must have at least two years of documented previous successful employment in the line of work in which the individual is self employed, or in a related occupation. ***Note***: A combination of one year of employment and formal education or training in the line of work in which the individual is self employed or in a related occupation is also acceptable.
less than one year	the income from the borrower may not be considered effective income.

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4. General Information on Self Employed Borrowers and Income Analysis, Continued

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4155.1 4.D.4.d General Documentation Requirements for Self Employed Borrowers

Self employed borrowers must provide the following documentation:

- signed, dated individual tax returns, with all applicable tax schedules for the most recent two years
- for a corporation, "S" corporation, or partnership, signed copies of Federal business income tax returns for the last two years, with all applicable tax schedules
- year to date profit and loss (P&L) statement and balance sheet, and
- business credit report for corporations and "S" corporations.

TOTAL Scorecard Accept Recommendation
No business tax returns are required if all of the following conditions are met:

- individual Federal income tax returns show increasing self employed income over the past two years
- funds to close are not coming from business accounts, and
- the proposed FHA-insured mortgage is not a cash out refinance.

Note: A business credit report for corporations or "S" corporations is *not* required for the TOTAL Scorecard Accept recommendation.

Reference: For additional information on TOTAL Scorecard recommendations for corporations or "S" corporations, see Page 13 of the *TOTAL Mortgage Scorecard User Guide at* http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm.

Continued on next page

4. General Information on Self Employed Borrowers and Income Analysis, Continued

4155.1 4.D.4.e Establishing a Borrower's Earnings Trend

When qualifying a borrower for a mortgage loan, the lender must establish the borrower's earnings trend from the previous two years using the borrower's tax returns.

If a borrower

- provides quarterly tax returns, the income analysis may include income through the period covered by the tax filings, or
- is *not* subject to quarterly tax returns, or does not file them, then the income shown on the P&L statement may be included in the analysis, provided the income stream based on the P&L is consistent with the previous years' earnings.

If the P&L statements submitted for the current year show an income stream considerably *greater* than what is supported by the previous year's tax returns, the lender must base the income analysis solely on the income verified through the tax returns.

If the borrower's earnings trend for the previous two years is *downward* and the most recent tax return or P&L is *less than the prior year's tax return*, the borrower's most recent year's tax return or P&L must be used to calculate his/her income.

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4. General Information on Self Employed Borrowers and Income Analysis, Continued

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4155.1 4.D.4.f P&L TOTAL Scorecard Accept/Refer Requirements

The TOTAL Scorecard Accept recommendation does not require a P&L and Balance Sheet, unless the income used to qualify the borrower exceeds that of the two-year average, based on tax returns. In such a case, either an audited P&L statement, or signed quarterly tax return is used to support the greater income stream.

The TOTAL Scorecard Refer recommendation requires a P&L and Balance Sheet, or income information directly from the IRS if both of the following conditions exist:

- more that seven months have elapsed since the business tax year's ending date, and
- income to the self employed borrower from each individual business is greater than 5 percent of his/her stable monthly income.

Reference: For additional information on TOTAL Scorecard recommendations, see Page 13 of the *TOTAL Mortgage Scorecard User Guide at* http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm.

4155.1 4.D.4.g Analyzing the Business's Financial Strength

To determine if the business is expected to generate sufficient income for the borrower's needs, the lender must carefully analyze the business's financial strength, including the

- source of the business's income
- general economic outlook for similar businesses in the area.

Annual earnings that are stable or increasing are acceptable, while businesses that show a significant decline in income over the analysis period are not acceptable, even if the current income and debt ratios meet FHA guidelines.

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5. Income Analysis: Individual Tax Returns (IRS Form 1040)

Introduction

This topic contains information on analyzing income for self employed borrowers through the review of IRS Form 1040. It includes information on

- the general policy on adjusting income based on a review of IRS Form 1040
- guidelines for analyzing IRS Form 1040, and
- earned income credit.

Change Date

May 10, 2009

4155.1 4.D.5.a General Policy on Adjusting Income Based on a Review of IRS Form 1040

The amount shown on a borrower's IRS Form 1040 as *adjusted gross income* must either be increased or decreased based on the lender's analysis of the individual tax return and any related tax schedules.

Reference: For information on particular items to analyze on IRS Form 1040, see HUD 4155.1 4.D.5.b.

4155.1 4.D.5.b Guidelines for Analyzing IRS Form 1040

The table below contains guidelines for analyzing IRS Form 1040.

IRS Form 1040 Heading	Description
Wages, Salaries and Tips	An amount shown under this heading may indicate that the individual • is a salaried employee of a corporation, or • has other sources of income. This section may also indicate that the spouse is employed, in which case the spouse's income must be subtracted from the borrower's adjusted gross income.

Continued on next page

5. Income Analysis: Individual Tax Returns (IRS Form 1040), Continued

4155.1 4.D.5.b Guidelines for Analyzing IRS Form 1040 (continued)

IRS Form 1040 Heading	Description
Business Income and Loss (from Schedule C)	Sole proprietorship income calculated on Schedule C is business income. Depreciation or depletion may be added back to the adjusted gross income.
Rents, Royalties, Partnerships (from Schedule E)	Any income received from rental properties or royalties may be used as income, after adding back any depreciation shown on Schedule E.
Capital Gain and Losses (from Schedule D)	Capital gains or losses generally occur only one time, and should not be considered when determining effective income. However, if the individual has a constant turnover of assets resulting in gains or losses, the capital gain or loss must be considered when determining the income. Three years' tax returns are required to evaluate an earning trend. If the trend • results in a gain, it may be added as effective income, or • consistently shows a loss, it must be deducted from the total income. Lender must document anticipated continuation of income through verified assets. ***Example***: A lender can consider the capital gains for an individual who purchases old houses, remodels them, and sells them for profit.

Continued on next page

5. Income Analysis: Individual Tax Returns (IRS Form 1040), Continued

4155.1 4.D.5.b Guidelines for Analyzing IRS Form 1040 (continued)

IRS Form 1040 Heading	Description
Interest and Dividend Income (from Schedule B)	This taxable/tax-exempt income may be added back to the adjusted gross income only if it • has been received for the past two years, and • is expected to continue. If the interest-bearing asset will be liquidated as a source of the cash investment, the lender must appropriately adjust the amount.
Farm Income or Loss (from Schedule F)	Any depreciation shown on Schedule F may be added back to the adjusted gross income.
IRA Distributions, Pensions, Annuities, and Social Security Benefits	The non-taxable portion of these items may be added back to the adjusted gross income, if the income is expected to continue for the first three years of the mortgage.
Adjustments to Income	Adjustments to income may be added back to the adjusted gross income if they are • IRA and Keogh retirement deductions • penalties on early withdrawal of savings • health insurance deductions, and • alimony payments.
Employee Business Expenses	Employee business expenses are actual cash expenses that must be deducted from the adjusted gross income.

6. Income Analysis: Corporate Tax Returns (IRS Form 1120)

Introduction

This topic contains information on analyzing corporate tax returns submitted on IRS Form 1120. It includes

- a description of a ***corporation***
- the need to obtain borrower percentage of ownership information, and
- analyzing corporate tax returns.

Change Date

May 10, 2009

4155.1 4.D.6.a Description: Corporation

A ***Corporation*** is a state-chartered business owned by its stockholders.

4155.1 4.D.6.b Need to Obtain Borrower Percentage of Ownership Information

Corporate compensation to the officers, generally in proportion to the percentage of ownership, is shown on the

- corporate tax return IRS Form 1120, and
- individual tax returns.

When a borrower's percentage of ownership does not appear on the tax returns, the lender *must* obtain the information from the corporation's accountant, along with evidence that the borrower has the right to any compensation.

Continued on next page

6. Income Analysis: Corporate Tax Returns (IRS Form 1120), Continued

4155.1 4.D.6.c Analyzing Corporate Tax Returns

In order to determine a borrower's self employed income from a corporation the adjusted business income must

- be determined, and
- multiplied by the borrower's percentage of ownership in the business.

The table below describes the items found on IRS Form 1120 for which an adjustment must be made in order to determine adjusted business income.

Adjustment Item	Description of Adjustment
Depreciation and Depletion	Add the corporation's depreciation and depletion back to the after-tax income.
Taxable Income	Taxable income is the corporation's net income before Federal taxes. Reduce taxable income by the tax liability.
Fiscal Year vs. Calendar Year	If the corporation operates on a fiscal year that is different from the calendar year, an adjustment must be made to relate corporate income to the individual tax return.
Cash Withdrawals	The borrower's withdrawal of cash from the corporation may have a severe negative impact on the corporation's ability to continue operating.

7. Income Analysis: "S" Corporation Tax Returns (IRS Form 1120S)

Introduction

This topic contains information on analyzing a borrower's self employed income from an "S" corporation. It includes

- a description of an "S" corporation, and
- information on analyzing "S" corporation tax returns.

Change Date

March 29, 2010

4155.1 4.D.7.a Description: "S" Corporation

An ***"S" Corporation*** is generally a small, start-up business, with gains and losses passed to stockholders in proportion to each stockholder's percentage of business ownership.

Income for owners of "S" corporations comes from W-2 wages, and is taxed at the individual rate. The IRS Form 1120S, *Compensation of Officers* line item is transferred to the borrower's individual IRS Form 1040.

Reference: For information on reviewing and analyzing IRS Form 1040, see HUD 4155.1 4.D.5.

4155.1 4.D.7.b Analyzing "S" Corporation Tax Returns

"S" corporation depreciation and depletion may be added back to income in proportion to the borrower's share of the corporation's income.

In addition, the income must also be reduced proportionately by the total obligations payable by the corporation in less than one year.

IMPORTANT: The borrower's withdrawal of cash from the corporation may have a severe negative impact on the corporation's ability to continue operating, and must be considered in the income analysis.

8. Income Analysis: Partnership Tax Returns (IRS Form 1065)

Introduction

This topic contains information on analyzing a self employed borrower's income from a partnership through the analysis of IRS Form 1065, including

- a description of a partnership, and
- information on analyzing partnership tax returns.

Change Date

March 29, 2010

4155.1 4.D.8.a Description: Partnership

A ***Partnership*** is formed when two or more individuals form a business, and share in profits, losses, and responsibility for running the company.

Each partner pays taxes on his/her proportionate share of the partnership's net income.

4155.1 4.D.8.b Analyzing Partnership Tax Returns

Both general and limited partnerships report income on IRS Form 1065, and the partners' share of income is carried over to Schedule E of IRS Form 1040.

The lender must review IRS Form 1065 to assess the viability of the business. Both depreciation and depletion may be added back to the income in proportion to the borrower's share of income.

Income must also be reduced proportionately by the total obligations payable by the partnership in less than one year.

IMPORTANT: Cash withdrawals from the partnership may have a severe negative impact on the partnership's ability to continue operating, and must be considered in the income analysis.

Reference: For information on reviewing IRS Form 1040, see HUD 4155.1 4.D.5.

Section E. Non Employment Related Borrower Income

Overview

In This Section

This section contains the topics listed in the table below.

1. Alimony, Child Support, and Maintenance Income

Introduction

This topic contains information on alimony, child support, and maintenance income requirements, including

- criteria for alimony, child support, and maintenance income, and
- alimony and support requirements for TOTAL Scorecard Accept/Refer recommendations.

Change Date

March 29, 2010

4155.1 4.E.1.a Alimony, Child Support and Maintenance Income Criteria

Alimony, child support, or maintenance income may be considered effective, if

- payments are likely to be received consistently for the first three years of the mortgage
- the borrower provides the required documentation, which includes a copy of the
  - final divorce decree
  - legal separation agreement,
  - court order, or
  - voluntary payment agreement, and
- the borrower can provide acceptable evidence that payments have been received during the last 12 months, such as
  - cancelled checks
  - deposit slips
  - tax returns, or
  - court records.

Notes:
- Periods less than 12 months may be acceptable, provided the lender can adequately document the payer's ability and willingness to make timely payments.
- Child support may be "grossed up" under the same provisions as non-taxable income sources.

Reference: For more information on "grossing up," see HUD 4155.1 4.E.5.a.

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1. Alimony, Child Support, and Maintenance Income, Continued

4155.1 4.E.1.b TOTAL Scorecard Accept/Refer Recommendation

The TOTAL Scorecard Accept and Refer recommendation for alimony, child support, and maintenance income requires evidence

- of receipt, using deposits on bank statements or cancelled checks for the most recent three months that support the amount used when qualifying, and
- that the claimed income will continue for at least three years.

For the financial details, use the front and pertinent pages of the divorce decree, settlement agreement and/or court order.

Reference: For more information on the TOTAL Scorecard recommendations, see the *TOTAL Mortgage Scorecard User Guide at* http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm.

2. Investment and Trust Income

Introduction

This topic contains information on analyzing investment and trust income, including

- analyzing interest and dividends
- trust income
- notes receivable income, and
- calculating qualifying ratios for investment properties.

Change Date

March 29, 2010

4155.1 4.E.2.a Analyzing Interest and Dividends

Interest and dividend income may be used as long as tax returns or account statements support a two-year receipt history. This income must be averaged over the two years.

Subtract any funds that are derived from these sources, and are required for the cash investment, before calculating the projected interest or dividend income.

4155.1 4.E.2.b Trust Income

Income from trusts may be used if guaranteed, constant payments will continue for at least the first three years of the mortgage term.

Required trust income documentation includes a copy of the Trust Agreement or other trustee statement, confirming the

- amount of the trust
- frequency of distribution, and
- duration of payments.

Trust account funds may be used for the required cash investment if the borrower provides adequate documentation that the withdrawal of funds will not negatively affect income. The borrower may use funds from the trust account for the required cash investment, but the trust income used to determine repayment ability cannot be affected negatively by its use.

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2. Investment and Trust Income, Continued

4155.1 4.E.2.c Notes Receivable Income

In order to include notes receivable income to qualify a borrower, he/she must provide

- a copy of the note to establish the amount and length of payment, and
- evidence that these payments have been consistently received for the last 12 months through
  - deposit slips
  - cancelled checks, or
  - tax returns.

If the borrower is not the original payee on the note, the lender must establish that the borrower is now a holder in due course, and able to enforce the note.

4155.1 4.E.2.d Calculating Qualifying Ratios for Eligible Investment Properties

Follow the steps in the table below to calculate an investment property's income or loss if the property to be insured is

- an eligible investment property, or
- sold through FHA's REO program.

Step	Action
1	Subtract the monthly payment (PITI) from the monthly net rental income of the subject property. ***Note***: Calculate the monthly net rental by taking the gross rents, and subtracting the 25 percent reduction or the HOC's percentage reduction for vacancies and repairs.
2	Does the calculation in Step 1 yield a positive number? • If *yes*, add the number to the borrower's monthly gross income. • If *no*, and the calculation yields a negative number, consider it a recurring monthly obligation.

Continued on next page

2. Investment and Trust Income, Continued

4155.1 4.E.2.d Calculating Qualifying Ratios for Eligible Investment Properties (continued)

Step	Action
3	Calculate the mortgage payment-to-income ratio (top or front-end ratio) by dividing the borrower’s current housing expense (principal residence) by the monthly gross income. ***Note***: The monthly gross income includes any positive cash flow from the subject investment property.
4	Calculate the total fixed payment-to-income ratio (bottom or back-end ratio) by dividing the borrower’s total monthly obligations, including any net loss from the subject investment property, by the borrower’s total monthly gross income.

3. Military, Government Agency, and Assistance Program Income

Introduction

This topic contains information on analyzing military, government agency, and assistance program income, including

- military income
- VA benefits
- government assistance programs
- mortgage credit certificates, and
- Section 8 home ownership vouchers.

Change Date

March 29, 2010

4155.1 4.E.3.a Military Income

Military personnel not only receive base pay, but often times are entitled to additional forms of pay, such as

- income from variable housing allowances
- clothing allowances
- flight or hazard pay
- rations, and
- proficiency pay.

These types of additional pay are acceptable when analyzing a borrower's income as long as the probability of such pay to continue is verified in writing.

Note: The tax-exempt nature of some of the above payments should also be considered.

Reference: For information about non-taxable income, see HUD 4155.1 4.E.5.

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3. Military, Government Agency, and Assistance Program Income, Continued

4155.1 4.E.3.b VA Benefits

Direct compensation for service-related disabilities from the Department of Veterans Affairs (VA) is acceptable, provided the lender receives documentation from the VA.

Education benefits used to offset education expenses are *not* acceptable.

4155.1 4.E.3.c Government Assistance Programs

Income received from government assistance programs is acceptable as long as the paying agency provides documentation indicating that the income is expected to continue for at least three years.

If the income from government assistance programs will not be received for at least three years, it may be considered as a compensating factor.

Unemployment income *must* be documented for two years, and there must be reasonable assurance that this income will continue. This requirement may apply to seasonal employment.

Reference: For information on analyzing income from seasonal employment, see HUD 4155.1.4.D.2.e.

4155.1 4.E.3.d Mortgage Credit Certificates

If a government entity subsidizes the mortgage payments either through direct payments or tax rebates, these payments may be considered as acceptable income.

Either type of subsidy may be added to gross income, or used directly to offset the mortgage payment, before calculating the qualifying ratios.

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3. Military, Government Agency, and Assistance Program Income, Continued

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4155.1 4.E.3.e Section 8 Home Ownership Vouchers

A monthly subsidy may be treated as income, if a borrower is receiving subsidies under the housing choice voucher home ownership option from a Public Housing Agency (PHA). Although continuation of the home ownership voucher subsidy beyond the first year is subject to Congressional appropriation, FHA has agreed that it will assume, for the purposes of underwriting, that the subsidy will continue for at least three years.

If the borrower is receiving the subsidy directly, the amount received is treated as income. The amount received may also be treated as non taxable income and be "grossed up" by 25 percent, which means that the amount of the subsidy, plus 25 percent of that subsidy may be added to the borrower's income from employment and/or other sources.

Lenders may treat this subsidy as an "offset" to the monthly mortgage payment (that is, reduce the monthly mortgage payment by the amount of the home ownership assistance payment before dividing by the monthly income to determine the payment-to-income and debt-to-income ratios). The subsidy payment must not pass through the borrower's hands.
The assistance payment must be

- paid directly to the servicing lender, or
- placed in an account that only the servicing lender may access.

Note: Assistance payments made directly to the borrower *must* be treated as income.

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4. Rental Income

Introduction

This topic contains information on analyzing rental income, including

- analyzing the stability of rental income
- rental income from borrower-occupied property
- income from roommates
- documentation required to verify rental income
- analyzing IRS Form 1040 Schedule E
- using current leases to analyze rental income
- the exclusion of rental income from a property being vacated by the borrower, and
- the policy exceptions to the exclusion of rental income from a principal residence being vacated by a borrower.

Change Date

March 29, 2010

4155.1 4.E.4.a Analyzing the Stability of Rental Income

Rent received for properties owned by the borrower is acceptable as long as the lender can document the stability of the rental income through

- a current lease
- an agreement to lease, or
- a rental history over the previous 24 months that is free of unexplained gaps greater than three months (such gaps could be explained by student, seasonal, or military renters, or property rehabilitation).

A separate schedule of real estate is not required for rental properties as long as all properties are documented on the URLA.

Note: The underwriting analysis may *not* consider rental income from any property being vacated by the borrower, except under the circumstances described in HUD 4155.1 4.E.4.h.

Continued on next page

4. Rental Income, Continued

4155.1 4.E.4.b Rental Income From Borrower Occupied Property

The rent for multiple unit property where the borrower resides in one or more units and charges rent to tenants of other units may be used for qualifying purposes.

Projected rent for the tenant-occupied units *only* may

- be considered gross income, only after deducting the HOC's vacancy and maintenance factor, and
- *not* be used as a direct offset to the mortgage payment.

Reference: For information about the HOC vacancy and maintenance factor, see the *HOC Reference* Guide at www.hud.gov/offices/hsg/sfh/ref/hsgrcont.cfm.

4155.1 4.E.4.c Income from Roommates in a Single Family Property

Income from roommates in a single family property occupied as the borrower's primary residence is *not* acceptable. Rental income from boarders however, *is* acceptable, if the boarders are related by blood, marriage, or law.

The rental income may be considered effective, if shown on the borrower's tax return. If not on the tax return, rental income paid by the boarder

- may be considered a compensating factor, and
- must be adequately documented by the lender.

4155.1 4.E.4.d Documentation Required to Verify Rental Income

Analysis of the following required documentation is necessary to verify all borrower rental income:

- IRS Form 1040 Schedule E, as described in HUD 4155.1 4.D.5.b, and
- current leases/rental agreements, as described in HUD 4155.1 4.E.4.f.

Continued on next page

4. Rental Income, Continued

4155.1 4.E.4.e Analyzing IRS Form 1040 Schedule E

The IRS Form 1040 Schedule E is required to verify all rental income. Depreciation shown on Schedule E may be added back to the net income or loss.

Positive rental income is considered gross income for qualifying purposes, while negative income must be treated as a recurring liability.

The lender *must* confirm that the borrower still owns each property listed, by comparing Schedule E with the real estate owned section of the URLA. If the borrower owns six or more units in the same general area, a map must be provided disclosing the locations of the units as evidence of compliance with FHA's seven-unit limitation.

Reference: For information about the FHA seven unit rental limitation, see HUD 4155.1 4.B.4.d.

4155.1 4.E.4.f Using Current Leases to Analyze Rental Income

The borrower can provide a current signed lease or other rental agreement for a property that was acquired since the last income tax filing, and is not shown on Schedule E.

In order to calculate the rental income

- reduce the gross rental amount by 25 percent (or the percentage developed by the jurisdictional HOC) for vacancies and maintenance
- subtract PITI and any homeowners' association dues, and
- apply the resulting amount to
  - income, if positive, or
  - recurring debts, if negative.

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4. Rental Income, Continued

4155.1 4.E.4.g Exclusion of Rental Income From Property Being Vacated by the Borrower

Underwriters may *not* consider any rental income from a borrower's principal residence that is being vacated in favor of another principal residence, except under the conditions described in HUD 4155.1 4.E.4.h

Notes:

- This policy assures that a borrower either has sufficient income to make both mortgage payments without any rental income, or has an equity position not likely to result in defaulting on the mortgage on the property being vacated.
- This applies *solely* to a principal residence being vacated in favor of another principal residence. It does *not* apply to existing rental properties disclosed on the loan application and confirmed by tax returns (Schedule E of form IRS 1040).

Continued on next page

4. Rental Income, Continued

4155.1 4.E.4.h Policy Exceptions Regarding the Exclusion of Rental Income From a Principal Residence Being Vacated by a Borrower

When a borrower vacates a principal residence in favor of another principal residence, the rental income, reduced by the appropriate vacancy factor as determined by the jurisdictional FHA HOC, *may* be considered in the underwriting analysis under the circumstances listed in the table below.

Reference: For information on jurisdictional HOC vacancy factors, see http://www.hud.gov/offices/hsg/sfh/ref/sfh2-21u.cfm.

Exception	Description
Relocations	The borrower is relocating with a new employer, or being transferred by the current employer to an area not within reasonable and locally-recognized commuting distance. A properly executed lease agreement (that is, a lease signed by the borrower and the lessee) of at least one year's duration after the loan is closed is required. ***Note***: FHA recommends that underwriters also obtain evidence of the security deposit and/or evidence the first month's rent was paid to the homeowner.
Sufficient Equity in Vacated Property	The borrower has a loan-to-value ratio of 75% percent or less, as determined either by • a current (no more than six months old) residential appraisal, or • comparing the unpaid principal balance to the original sales price of the property. ***Note***: The appraisal, in addition to using forms Fannie Mae1004/Freddie Mac 70, may be an exterior-only appraisal using form Fannie Mae/Freddie Mac 2055, and for condominium units, form Fannie Mae1075/Freddie Mac 466.

5. Non Taxable and Projected Income

Introduction

This topic contains information on analyzing non-taxable and projected income, including

- types of non-taxable income
- regular, non-taxable income
- analyzing projected income, and
- projected income for a new job.

Change Date

March 29, 2010

4155.1 4.E.5.a Types of Non Taxable Income

Certain types of regular income may not be subject to Federal tax. Such types of non taxable income include

- some portion of Social Security, some Federal government employee retirement income, Railroad Retirement Benefits, and some state government retirement income
- certain types of disability and public assistance payments
- child support
- military allowances, and
- other income that is documented as being exempt from Federal income taxes.

4155.1 4.E.5.b Adding Non Taxable Income to a Borrower's Gross Income

The amount of continuing tax savings attributed to regular income not subject to Federal taxes may be added to the borrower's gross income.

The percentage of non-taxable income that may be added *cannot* exceed the appropriate tax rate for the income amount. Additional allowances for dependents are *not* acceptable.

The lender

- must document and support the amount of income *grossed up* for any non-taxable income source, and
- should use the tax rate used to calculate the borrower's last year's income tax.

Note: If the borrower is not required to file a Federal tax return, the tax rate to use is 25 percent.

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5. Non Taxable and Projected Income, Continued

4155.1 4.E.5.c Analyzing Projected Income

Projected or hypothetical income is *not* acceptable for qualifying purposes. However, exceptions are permitted for income from the following sources:

- cost-of-living adjustments
- performance raises, and
- bonuses.

For the above exceptions to apply, the income must be

- verified in writing by the employer, and
- scheduled to begin within 60 days of loan closing.

4155.1 4.E.5.d Projected Income for a New Job

Projected income is acceptable for qualifying purposes for a borrower scheduled to start a new job within 60 days of loan closing if there is a guaranteed, non-revocable contract for employment.

The lender *must* verify that the borrower will have sufficient income or cash reserves to support the mortgage payment and any other obligations between loan closing and the start of employment. Examples of this type of scenario are teachers whose contracts begin with the new school year, or physicians beginning a residency after the loan closes fall under this category.

The loan is *not eligible for endorsement* if the loan closes more than 60 days before the borrower starts the new job. To be eligible for endorsement, the lender must obtain from the borrower a pay stub or other acceptable evidence indicating that he/she has started the new job.

Section F. Borrower Qualifying Ratios

Overview

In This Section

This section contains the topics listed in the table below.

1. General Information on Borrower Qualifying

Introduction

This topic contains general information on qualifying borrowers for a mortgage loan, including

- lender responsibility when qualifying a borrower, and
- the importance of careful underwriting analysis.

Change Date

May 10, 2009

4155.1 4.F.1.a Lender Responsibility When Qualifying a Borrower

The lender is responsible for adequately analyzing the probability that a borrower will be able to repay the mortgage obligation according to the terms of the loan.

This responsibility includes using debt-to-income ratios and compensating factors when qualifying a borrower. Qualifying ratios can be exceeded when significant compensating factors exist.

4155.1 4.F.1.b Importance of Careful Underwriting Analysis

Underwriting requires a careful analysis of many aspects of the mortgage.

Each loan is a separate and unique transaction, and there may be multiple factors that demonstrate a borrower’s ability and willingness to make timely mortgage payments.

Simply establishing that a loan transaction meets minimal standards does not necessarily constitute prudent underwriting. When qualifying a borrower, it is important to avoid the danger of “layering flexibilities” when assessing the mortgage insurance risk.

2. Debt to Income Ratios

Introduction

This topic contains information on using debt-to-income ratios to qualify a borrower, including

- general information about debt-to-income ratios
- mortgage payment expense to effective income ratio, and
- total fixed payment to effective income ratio.

Change Date

March 29, 2010

4155.1 4.F.2.a General Information About Debt to Income Ratios

Debt to income ratios are used to determine whether the borrower can reasonably be expected to meet the expenses involved in home ownership, and provide for his/her family. In order to make this determination, the lender must complete the following two ratios:

- the Mortgage Payment Expense to Effective Income ratio, as described in HUD 4155.1 4.F.2.b, and
- the Total Fixed Payment to Effective Income ratio, as described in HUD 4155.1 4.F.2.c.

Note: For loans to be scored through the TOTAL Scorecard, the debt-to-income ratios must be calculated for entry into the Automated Underwriting System (AUS) to be evaluated by TOTAL.

Continued on next page

2. Debt to Income Ratios, Continued

4155.1 4.F.2.b Mortgage Payment Expense to Effective Income Ratio

The relationship of the mortgage payment to income is considered acceptable if the total mortgage payment does not exceed 31 percent of the gross effective income.

A ratio exceeding 31 percent may be acceptable only if significant compensating factors, as discussed in HUD 4155.1 4.F.3, are documented and recorded on Form HUD-92900-LT, *FHA Loan Underwriting and Transmittal Summary*.

For those borrowers who qualify under FHA's Energy Efficient Homes (EEH), the ratio is set at 33 percent.

Note: The total mortgage payment includes

- principal and interest
- escrow deposits for real estate taxes
- hazard insurance
- the mortgage insurance premium
- homeowners' association dues
- ground rent
- special assessments, and
- payments for any acceptable secondary financing.

4155.1 4.F.2.c Total Fixed Payment to Effective Income Ratio

The relationship of total obligations to income is considered acceptable if the total mortgage payment and all recurring charges do not exceed 43 percent of the gross effective income.

A ratio exceeding 43 percent may be acceptable only if significant compensating factors, as discussed in HUD 4155.1 4.F.3, are documented and recorded on Form HUD-92900-LT, *FHA Loan Underwriting and Transmittal Summary*. For those borrowers who qualify under FHA's EEH, the ratio is set at 45 percent.

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2. Debt to Income Ratios, Continued

4155.1 4.F.2.d Estimating Real Estate Taxes When Determining Debt to Income Ratios

For real estate taxes, lenders must use accurate estimates of monthly property tax escrows when qualifying borrowers. In new construction cases, property tax estimates must be based on the land and completed improvements, not just on the land value.

Reference: For information on projecting and collecting real estate tax payments, see HUD 4155.2 6.A.1.i.

3. Compensating Factors

Introduction

This topic contains information on using compensating factors to qualify a borrower, including

- documentation of the use of compensating factors, and
- compensating factors benchmark guidelines.

Change Date

March 29, 2010

4155.1 4.F.3.a Documentation of the Use of Compensating Factors

Compensating factors that are used to justify approval of mortgage loans with ratios that exceed benchmark guidelines must be recorded on the *Underwriter Comments* section of Form HUD-92900-LT, *FHA Loan Underwriting and Transmittal Summary*. Any compensating factor used to justify mortgage approval must also be supported by documentation.

TOTAL Scorecard Accept Recommendation
The TOTAL Scorecard Accept recommendation does not require documented compensating factors, even if qualifying ratios have exceeded FHA benchmark guidelines.

Reference: For more information on the TOTAL Scorecard recommendations, see the *TOTAL Mortgage Scorecard User Guide at* http://www.hud.gov/offices/hsg/sfh/lender/total_scorecard.cfm.

4155.1 4.F.3.b Compensating Factors Benchmark Guidelines

The table below describes the compensating factors that may be used to justify approval of mortgage loans with ratios that exceed FHA benchmark guidelines.

Compensating Factor	Guideline Description
Housing Expense Payments	The borrower has successfully demonstrated the ability to pay housing expenses greater than or equal to the proposed monthly housing expenses for the new mortgage over the past 12-24 months.

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3. Compensating Factors, Continued

4155.1 4.F.3.b Compensating Factors Benchmark Guidelines (continued)

Compensating Factor	Guideline Description
Down Payment	The borrower makes a large down payment of 10 percent or higher toward the purchase of the property.
Accumulated Savings	The borrower has demonstrated • an ability to accumulate savings, and • a conservative attitude toward using credit.
Previous Credit History	A borrower’s previous credit history shows that he/she has the ability to devote a greater portion of income to housing expenses.
Compensation or Income Not Reflected in Effective Income	The borrower receives documented compensation or income that is not reflected in effective income, but directly affects his/her ability to pay the mortgage. This type of income includes food stamps, and similar public benefits.
Minimal Housing Expense Increase	There is only a minimal increase in the borrower’s housing expense.

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3. Compensating Factors, Continued

4155.1 4.F.3.b Compensating Factors Benchmark Guidelines (continued)

Compensating Factor	Guideline Description
Substantial Cash Reserves	The borrower has substantial documented cash reserves (at least three months worth) after closing. The lender must judge if the substantial cash reserve asset is liquid or readily convertible to cash, and can be done so absent retirement or job termination, when determining if the asset can be included as cash reserves, or cash to close. Funds and/or "assets" that are *not* to be considered as cash reserves include • equity in other properties, and • proceeds from a cash-out refinance. Lenders may use a portion of a borrower's retirement account, subject to the conditions stated below. To account for withdrawal penalties and taxes, only 60% of the vested amount of the account may be used. The lender must document the existence of the account with the most recent depository or brokerage account statement. In addition, evidence must be provided that the retirement account allows for withdrawals for conditions other than in connection with the borrower's employment termination, retirement, or death. If withdrawals can only be made under these circumstances, the retirement account may not be included as cash reserves. If any of these funds are also to be used for loan settlement, that amount must be subtracted from the amount included as cash reserves. Similarly, any gift funds that remain in the borrower's account following loan closing, subject to proper documentation, may be considered as cash. ***Note***: Reserves from retirement accounts and gifts as described above may be considered as cash reserves when scoring the mortgage application through TOTAL. ***Reference***: For information on acceptable sources of cash reserve funding, see HUD 4155.1 5.B.

Continued on next page

3. Compensating Factors, Continued

4155.1 4.F.3.b Compensating Factors Benchmark Guidelines (continued)

Compensating Factor	Guideline Description
Substantial Non-Taxable Income	The borrower has substantial non-taxable income. ***Note***: This applies if no adjustment was previously made when computing ratios.
Potential for Increased Earnings	The borrower has a potential for increased earnings, as indicated by job training or education in his/her profession.
Primary Wage-Earner Relocation	The home is being purchased because the primary wage-earner is relocating, and the secondary wage-earner • has an established employment history • is expected to return to work, and • has reasonable prospects for securing employment in a similar occupation in the new area. ***Note***: The underwriter must document the availability of the potential employment.